
AUDIT REPORT



UNITED MORTGAGE CORPORATION NON-SUPERVISED MORTGAGEE HAUPPAUGE, NEW YORK

2006-NY-1001

November 18, 2005

OFFICE OF AUDIT
NEW YORK/NEW JERSEY



Issue Date

November 18, 2005

Audit Report Number

2006-NY-1001

TO: Brian D. Montgomery, Assistant Secretary for Housing-Federal Housing
Commissioner, H

FROM: *Edgar Moore*
Edgar Moore, Regional Inspector General for Audit, 2AGA

SUBJECT: United Mortgage Corporation, Hauppauge, NY Did Not Always Comply with
HUD/Federal Housing Administration Loan Origination Requirements

HIGHLIGHTS

What We Audited and Why

We audited United Mortgage Corporation (United Mortgage), a non-supervised direct endorsement lender located in Hauppauge, New York, because its default rate for loans originated and underwritten during the period November 1, 2002 through October 31, 2004 was higher than the New York State average default rate.

The audit objectives were to determine whether United Mortgage: (1) complied with the U.S. Department of Housing and Urban Development (HUD) regulations in the origination of Federal Housing Administration loans, and (2) developed and implemented a quality control plan that complied with HUD requirements.

What We Found

United Mortgage did not originate 13 of the 33 loans reviewed in accordance with HUD requirements. The 13 loans were approved with deficiencies that involved inadequate or incomplete compensating factors; failure to re-establish good credit following a bankruptcy; inadequate income verification; files containing questionable documents; inadequate debt verification; and inadequate review of appraisals. We attributed these deficiencies to United Mortgage's failure to use due care when originating the loans. As a result, mortgages valued at \$1,751,300 were

approved for unqualified borrowers, causing HUD to assume an unnecessary insurance risk.

Further, United Mortgage did not follow HUD requirements pertaining to supporting significant compensating factors as they relate to an additional 7 loans reviewed. As a result, mortgages amounting to \$1,060,100 were approved for unqualified borrowers, causing HUD to assume an unnecessary insurance risk.

United Mortgage implemented a quality control plan that for the items tested was in compliance with HUD requirements.

What We Recommend

We recommend that the assistant secretary for housing- federal housing commissioner require United Mortgage to reimburse HUD for claims and fees paid on one loan amounting to \$154,921. We are also requesting indemnification for potential losses on the 12 active loans with significant underwriting deficiencies. These 12 loans are valued at \$1,605,950. We further recommend that HUD examine the 7 active loans valued at \$1,060,100 that lacked support for compensating factors to determine if they should have been approved and if they should be indemnified.

For each recommendation without a management decision, please respond and provide status reports in accordance with HUD Handbook 2000.06, REV-3. Please furnish us copies of any correspondence or directives issued because of the audit.

Auditee's Response

United Mortgage officials did not agree with our conclusion that they did not follow HUD's requirements in the origination of Federal Housing administration loans.

We discussed the contents of the report with United Mortgage officials during the audit and at an exit conference held on October 19, 2005 and they provided their written comments on October 25, 2005. Appendix B of this report contains the complete text of United Mortgage's comments, along with our evaluation of the comments.

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BACKGROUND AND OBJECTIVES

United Mortgage Corporation (United Mortgage) is a non-supervised lender that became a HUD approved lender on May 19, 1992. United Mortgage's home office is located in Hauppauge, NY, and it has 11 separate branch offices located throughout the country. United Mortgage has five loan correspondents and is acting as principal for one authorized agent.

Between November 1, 2002 and October 31, 2004, United Mortgage originated 433 Federal Housing Administration insured mortgages. We selected United Mortgage for audit because its 3.42 percent default rate for loans originated and underwritten during the period November 1, 2002 through October 31, 2004 was higher than the average default rate for the State of New York, which was 2.18 percent.

The objectives of this audit were to determine whether United Mortgage (1) complied with HUD regulations in the origination of Federal Housing Administration loans, and (2) developed and implemented a quality control plan that complied with HUD requirements.

RESULTS OF AUDIT

Finding 1: United Mortgage Did Not Follow HUD Requirements When Originating Loans

United Mortgage did not comply with HUD requirements in the origination of 13 of the 33 loans included in our review. The 13 loans contained deficiencies that should have precluded their approval. The deficiencies involved loans with inadequate or incomplete compensating factors; files containing questionable documents; inadequate debt verification; and inadequate review of appraisals. We attribute these deficiencies to United Mortgage's failure to use due care when originating the loans. As a result, the HUD/Federal Housing Administration Insurance Fund incurred a loss of \$154,921, and continues to be at risk for \$2,811,400.

HUD Requirements

HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance, prescribes basic underwriting requirements for HUD-insured single-family mortgage loans. Lenders must ensure that borrowers have the ability and willingness to repay the mortgage debt. Lenders are to obtain and verify information with at least the same care that would be exercised if the lender was originating a mortgage entirely dependent on the property as security to protect its investment.

HUD Handbook 4155.1 also requires lenders to determine a borrower's ability and willingness to repay the mortgage debt and, thus, limit the probability of default or collection difficulties. Lenders should evaluate the stability of income, funds to close, credit history, qualifying ratios, and compensating factors. They must ensure the application package contains sufficient documentation to support their decision to approve the mortgage loan. United Mortgage did not always follow the above requirements in its loan originations.

Origination and Underwriting Deficiencies

We found origination deficiencies in 13 of 33 loans we reviewed with beginning amortization dates between November 1, 2002, and October 31, 2004. These deficiencies occurred because United Mortgage did not exercise due diligence in adequately supporting compensating factors, verifying debt, income, and gift documentation, and reviewing appraisal information.

Specifically, we found that (a) ratios exceeded HUD standards without compensating factors or without adequate compensating factors (four loans), (b) borrower's did not re-establish good credit following bankruptcy (three loans), (c) income verification were inadequate (three loans), (d) files contained questionable documents (two loans), (e) debt verification were inadequate (two loans), and (f) appraisal reviews were inadequate (two loans).

Inadequate or Incomplete Compensating Factors

HUD Handbook 4155.1, REV-4, paragraphs 2-12 and 2-13 provides that the borrowers total mortgage payment to effective income ratio and total fixed payment to effective income ratio cannot exceed 29 percent and 41 percent respectively without listing significant compensating factors.

In one loan (Case Number 251-3042694), the borrower had a mortgage payment expense to effective income ratio of 37.04 and a total fixed payment to effective income ratio of 45.25 percent. Conservative use of credit, good earnings potential, and not using overtime or bonus income to qualify were listed as compensating factors. However, we determined that the credit report and the available assets did not support the compensating factor of conservative use of credit and an ability to accumulate savings. The bank account showed a balance of \$1,919 at the time the mortgage credit analysis worksheet was prepared. Furthermore, the borrower had opened a credit line 3 months prior to closing and the balance was close to its maximum allowable limit. In addition, United Mortgage's case files contained insufficient supporting documentation for the other two compensating factors. The case files did not contain evidence that there was a potential for increased earnings as indicated by job training or education in the borrower's profession, and the verification of employment did not provide evidence that the overtime and bonus income was likely to continue.

In two other loans we reviewed (Case Numbers 371-3362145 and 374-4236831), the borrowers total fixed payment to effective income or backend ratios were 44.96 percent and 45.09 percent, respectively. However, the loans were approved without any compensating factors listed on the mortgage credit analysis worksheet.

In another loan (Case Number 374-4347581), the loan had a front ratio of 36.13 and a back ratio of 43.85 percent. Contractual pay increases, conservative use of credit, and good earnings potential were listed as compensating factors. However, the files did not support any of these compensating factors, as indicated by job training or education in the borrower's profession.

Because of the compensating factor concerns identified above, we selected an additional 16 loans to review only to determine whether United Mortgage obtained adequate compensating factors to support its decision to approve loans for borrowers with high total debt to income or backend ratios. We determined that 9 of the 16 additional loans selected did not contain adequate compensating

factors. Two of these loans were paid in full thus we are requesting HUD to examine the 7 active loans with deficient compensating factors to determine whether they should have been approved. The seven loans are Case Numbers 371-3355512, 351-4593484, 292-4475818, 371-3356599, 374-4415719, 371-3401203, 052-3495166.

The Borrower Did Not Re-establish Good Credit Following Bankruptcy

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-3E states that a bankruptcy will not disqualify the borrower from Federal Housing Administration insurance if at least two years have passed since the bankruptcy was discharged and the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs.

In three of the loans we reviewed (Case Numbers 371-3330273, 371-3372063, and 371-3129664), the borrower did not re-establish good credit following a bankruptcy. In each of these cases, the borrowers' credit reports indicated that the borrowers had chosen to incur new credit obligations since the discharge date of their bankruptcies. In fact, one borrower opened 11 new credit lines, had a \$35,279 credit limit and incurred \$30,838 in debt. In addition, the same borrower's prior mortgage had five instances of late payments greater than 90 days. Further, for each of the borrowers there was no indication from the files that they re-established good credit nor demonstrated an ability to manage their financial affairs.

Inadequate Income Verification

HUD Handbook 4155.1, REV-4, CHG-1, paragraph 2-6 provides that the anticipated amount of income, and the likelihood of its continuance, must be established to determine a borrower's capacity to repay mortgage debt. In addition, the lender is required to verify the borrower's employment for the most recent two full years.

In three of the loans we reviewed (Case Numbers 374-4347581, 351-4605626, and 291-3251765), we determined that the loans contained inadequate income verification. In one of the loans (Case Number 374-4347581), United Mortgage indicated that the borrower's gross monthly income was \$6,096.70. However, based on the documents in the files we calculated it to be \$5,679.55. This change increased the total fixed payment to effective income or backend ratio to 47.07 percent, which is in excess of HUD's threshold. In the other two cases (Case Numbers 351-4605626 and 291-3251765), United Mortgage failed to verify the borrower's employment for the most recent two full years. In both cases, the borrowers indicated that they worked in their current positions for periods of less than two years, at the time of application; yet, the files did not adequately document the previous employment. The loan application for one of the

borrowers details eight months of employment and one year of self employment. However, the case files did not contain documents to support the timeframe or the amount of income generated by the borrower while self employed, such as tax returns and year-to-date profit and loss statements.

Questionable Documents

HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3C requires that judgments must be paid off before the mortgage loan is eligible for endorsement. Also, HUD Handbook 4155.1, REV-4, paragraph 2-11C states that if a debt payment, such as a student loan, is scheduled to begin within twelve months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis unless the borrower can provide evidence that the debt may be deferred to a period outside this timeframe.

United Mortgage failed to adequately verify questionable documents contained in the files. The documents included a questionable judgment verification and questionable debt verification. For example, the file for case number 374-4347581 included two letters explaining that judgments totaling \$4,876 had been satisfied. Each of these letters was provided to United Mortgage via facsimile and contained incomplete header information. However, the files did not contain evidence of reverification of the letters, nor the source of the payment that satisfied the judgment. In another example, the file for case number 061-2722023 contained documents from a university attesting that the borrower had been a student through 2003. Thus, on the premise that the student loans were not due for repayment until the following year, the loans were not considered in the underwriting analysis. However, the loans became due shortly after closing. Therefore, this debt should have been included as part of the underwriting analysis of the borrower's liabilities. Had these debts been properly analyzed, the borrowers may not have qualified for the loans.

Inadequate Debt Verification

HUD Handbook 4155.1, REV-4, paragraph 2-11A states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense, and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending ten months or more.

In two of the loans we reviewed (Case Numbers 061-2722023 and 091-3646170), we determined that the files contained inadequate debt verification. In one of the loans (Case Number 061-2722023), the borrower had numerous inquiries on her credit report. However, United Mortgage did not require the borrower to explain

the inquiries that were on the report. These credit items were significant because the quality control review performed on this loan found that a liability that was incurred between the application and the closing was not included in the approval of the loan. In the other loan file (Case Number 091-3646170), United Mortgage did not include a payment in the calculation of monthly debt on the mortgage credit analysis worksheet. According to the borrower's credit report, the payment was for an auto loan and should have been included in the total monthly debt. This payment would have increased the borrower's total fixed payment to effective income ratio to 61.19 percent.

Inadequate Appraisal Review

Mortgagee Letter 03-07 states that if a home's re-sale date is between 91 and 180 days following acquisition by the seller, the lender is required to obtain a second appraisal made by another appraiser if the resale price is 100 percent or more over the price paid by the seller when the property was acquired. As an example, if a property is re-sold for \$80,000 within six months of the seller's acquisition of that property for \$40,000, the mortgage lender must obtain a second independent appraisal supporting the \$80,000 sales price. The mortgage lender may provide documentation showing the costs and extent of rehabilitation that went into the property that resulted in the increased value; however, the lender must still obtain the second appraisal.

In two of the loans we reviewed (Case Numbers 351-4605626 and 371-3386266), there was a significant increase in the sales price of the home over a short period of time. However, the Uniform Residential Appraisal Reports did not provide sufficient information to justify and substantiate a large increase in value and United Mortgage did not question the values. For example, the subject property pertaining to Case Number 371-3386266 was sold for \$52,500 on October 24, 2003. The appraised value was \$147,500 on April 18, 2004. This was a 181 percent increase in value over a 6-month period. The time period between prior sales date and the date of the sales contract was 4 months. However, the second appraisal was conducted prior to the accepted appraisal, and did not support the increase in the sales price.

Conclusions

As of August 31, 2005, five of the loans we reviewed that contained deficiencies were in default, seven were current, and a claim had been paid on one. We are requesting reimbursement to HUD for the loan that had claims and fees paid on it amounting to \$154,921. We are also requesting indemnification for the other 12 loans with significant underwriting deficiencies that are active. The value of these loans amounts to \$1,605,950 and would represent funds to be put to better use if indemnified. Indemnification of these loans would preclude a potential future

claim against the Federal Housing Administration insurance fund. Regarding the seven additional active loans that contained inadequate support for compensating factors, HUD should review the underwriting for these loans to determine if they should have been approved and if they should be indemnified. There were an additional two loans with significant underwriting deficiencies, however they were paid in full. Since there is no risk to the Federal Housing Administration insurance fund for the two loans that were paid in full, we are not requesting HUD to review them.

The above deficiencies occurred because United Mortgage did not have adequate controls to ensure that loans were processed in accordance with all applicable HUD requirements. The deficiencies resulted in the approval of mortgages for borrowers whose qualifications are questionable thus causing HUD to assume an unnecessary insurance risk.

Appendix C provides a chart summarizing the loan processing deficiencies; while Appendix D provides the details of the deficiencies identified on the 13 cited loans. Appendix E to this report provides a detailed narrative case presentation of the additional seven loans with inadequate compensating factors.

Recommendations

We recommend that HUD, the Assistant Secretary for Housing-Federal Housing Commissioner, require United Mortgage to:

- 1A. Reimburse HUD for the loss incurred resulting from claims and fees paid on case number 371-3386266 in the amount of \$154,921.
- 1B. Indemnify HUD against potential future losses on 12 loans totaling \$1,605,950, which are considered as funds to be put to better use since indemnification prevents future claims against the Federal Housing Administration insurance fund.
- 1C. Submit a corrective action plan to HUD that will assure compliance with all HUD guidelines regarding the origination and underwriting of Federal Housing Administration insured loans.

We further recommend that HUD, the Assistant Secretary for Housing-Federal Housing Commissioner:

- 1D. Examine the additional 7 active loans valued at \$1,060,100 that lacked support for compensating factors and determine whether they were properly underwritten and approved, and whether they should be indemnified.

SCOPE AND METHODOLOGY

We sampled 33 of the 433 loans that were originated by United Mortgage during the timeframe from November 1, 2002 through October 31, 2004. We focused our sample on loans that have gone into default within the first two years. Twenty-seven loans were selected representing 100 percent of the active loans that had gone into default at least once. The remaining six loans were selected based on other audit indicators. We performed detailed file reviews on these loans. In addition to the detailed file reviews, we selected an additional sample of 16 loans to determine whether United Mortgage obtained adequate compensating factors to support its decisions to approve loans for borrowers with high debt to income or backend ratios. These loans had total fixed payment to effective income ratios in excess of 45 percent and closed in calendar year 2004. The results of our testing apply only to the 49 loans selected, and cannot be projected over the universe of the 433 loans.

To achieve our audit objectives, we reviewed the Homeownership Center's endorsement files, as well as case files provided by United Mortgage. We also reviewed United Mortgage's quality control procedures in order to assess whether they were adequate and properly implemented as per HUD requirements.

We interviewed United Mortgage's staff in order to obtain an understanding of the policies and procedures related to United Mortgage's management controls. We also analyzed Post Endorsement Technical Reviews.

We performed our audit fieldwork from December 2004 through August 2005. Our audit work was performed at United Mortgage's home office in Hauppauge, New York. The audit was conducted in accordance with generally accepted government auditing standards.

INTERNAL CONTROLS

Internal controls are an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved:

- Effectiveness and efficiency of operations,
- Reliability of financial reporting, and
- Compliance with applicable laws and regulations.

Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objectives:

- Program operations - Policies and procedures that management has implemented to reasonably ensure that a program meets its objectives.
- Compliance with laws and regulations - Policies and procedures that management has implemented to reasonably ensure that resource use is consistent with laws and regulations.
- Safeguarding resources - Policies and procedures that management has implemented to reasonably ensure that resources are safeguarded against waste, loss, and misuse.
- Validity and reliability of data - Policies and procedures that management has implemented to reasonably ensure that valid and reliable data are obtained, maintained, and fairly disclosed in reports.

We assessed the relevant controls identified above.

A significant weakness exists if management controls do not provide reasonable assurance that the process for planning, organizing, directing, and controlling program operations will meet the organization's objectives.

Significant Weaknesses

Based on our review, the following items are considered significant weaknesses:

- United Mortgage did not ensure that certain loans were processed in accordance with all applicable HUD/Federal Housing Administration requirements.
(See finding one).

Appendices

Appendix A

SCHEDULE OF QUESTIONED COSTS AND FUNDS TO BE PUT TO BETTER USE

Types of Questioned Costs

<u>Recommendation number</u>	<u>Ineligible costs 1/</u>	<u>Funds to be put to better use 2/</u>
1-A	\$154,921	
1-B		\$1,605,950
1-D		\$1,060,100
Total	<u>\$154,921</u>	<u>\$2,666,050</u>

1/ Ineligible costs are costs charged to a HUD-financed or HUD-insured program or activity that the auditor believes are not allowable by law; contract; or Federal, State, or local policies or regulations.

2/ “Funds to be put to better use” are quantifiable savings that are anticipated to occur if an Office of Inspector General (OIG) recommendation is implemented, resulting in reduced expenditures at a later time for the activities in question. This includes costs not incurred, deobligation of funds, withdrawal of interest, reductions in outlays, avoidance of unnecessary expenditures, loans and guarantees not made, and other savings.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION



UNITED MORTGAGE CORP

October 25, 2005

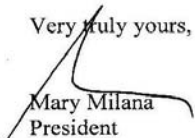
U.S. Department of Housing and urban Development
Office of Inspector General
26 Federal Plaza, Room 3430
New York, New York 10278
Attn: Mr. Edgar Moore
Regional Inspector General

Dear Mr. Moore:

Enclosed please find my response to the tentative findings developed during the audit of United Mortgage Corp.

Please give me a call should you need anything further.

Very truly yours,


Mary Milana
President

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UNITED MORTGAGE CORP

Finding 1: United Mortgage Did Not Follow HUD Requirements When Originating Loans.

The conclusions drawn by the OIG that United Mortgage did not follow HUD's requirements in the origination of FHA loans are inaccurate and unfounded. A detailed response addressing each of the findings is included in the report. Given the limited timeframe of 15 business days (initially 11 days) to respond to a report that was seven months in its compilation, a recap rather than a full comments were given for the seven loans where issues were raised regarding compensating factors. However, United will be prepared to respond at greater length if required.

Auditee's Response:

Seeking reimbursement and indemnifications for the loans reviewed in this audit is unreasonable and ultimately destructive to the FHA program. Further the heavy handed and disingenuous findings, such as these, has contributed to the decline of lenders participation in the FHA program. This decline has no doubt caused significant growth in the Sub Prime market, much to the detriment of the American home buying public by costing them dearly in higher rates, points and fees.

The auditors reviewed 11.3% of the loans originated by United for the period of 11/01/2002 through 10/31/2004. The OIG cited the reason for this review was due to United's default rate for FHA loan it originated being "higher then the New York State average default rate" which is inaccurate and misleading. Default ratings are listed on Neighborhood Watch on a quarterly basis and for the period ending September 2004 United's New York "current default" rate was 2.86% however even using the default rate of 3.42% as quoted by the auditors United was still well within FHA tolerances. Furthermore, we had provided numerous pages of documentation to the auditors explaining the default was incorrectly inflated due to reporting errors made by a mortgage loan servicer, which affected other mortgagees as well. We also notified HUD of the difficulty we were having in our efforts to correct the default data on Neighborhood Watch and the incorrect information being captured on FHA's "Credit Alert Interactive Voice Response System" better known as "CAIVRS". The auditors did not consider this information and continued to conduct the audit as if United was under a serious "investigation".

In reviewing past audit's conducted by the OIG even in instances where the default rate exceeded 10% and in shops where there was criminal intent by the mortgagee one could not find an instance where the scope of the "investigation" was any where near the number of files reviewed in this audit, 49 loans selected from 433 closed loans.

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Comment 2

I cannot begin to explain the number of person-hours and effort that was spent in defending United's underwriting policies and procedures. We are a small company and do not have the financial resources to obtain outside "professional" assistance to respond to this type of audit. The time spent by our key people in research and in defense of our position has had negative consequences to the financial position of this company.

United Mortgages prides itself on making loans to lower income families in underserved areas as indicated by our FHA loan portfolio. United has never been involved in "abuse" of the FHA program and we have enjoyed a good record with FHA over the 14 years we have been Direct Endorsement Lenders. To give further understanding of the tone of the audit when I objected to the auditor's change of previously made visit as it conflicted with my scheduled vacation I was threatened with "impeding" the examination and a "fine of \$10,000". Thankfully, the Director interceded on my behalf and I was able to reschedule to a more convenient time.

Our staff attend HUD seminars, obtain written clarification on HUD policies should any question be raised and have Handbooks, Mortgagee letters and all policies and guidelines available via the internet to ensure we are complying with the regulations. As a result, I would like to add that we were one of the few lenders audited by the OIG whose "Quality Control" program met HUD guidelines. What I am trying to convey are the efforts made to ensure that United is staying updated and knowledgeable regarding FHA program guidelines.

While the OIG may not agree with our interpretations of the guidelines, the Office of the Inspector General's "FHA Case File Review" dated May 15, 2003, Finding 1 stated, "Current restrictions on bad credit are very flexible, but are often subjective. The subjective nature of the criteria can provide deserving families the opportunity for home ownership, but it can be overly permissive and tolerant towards borrowers with bad credit histories". In addition, Finding 1, page 3 also states, "HUD Handbook 4155.1 REV-4 CHG-1 provides rules and guidance for credit approval. The rules are very flexible and are often stated in subjective terms, relying on the judgment of the underwriter to determine credit worthiness". Also, page 5 of the report states "The credit approval process lacks objective measures to guide underwriting and to provide risk assessment measures for quality assurance reviews. This criteria is somewhat subjective in terms of what constitutes bad credit. The subjective nature of the criteria and its allowance for exception can provide deserving families the opportunity for home ownership, but it can also be overly permissive and tolerant toward borrowers with bad credit histories". As the OIG stated in the FHA review that the rules are "flexible and are often stated in subjective terms relying on the judgment of the underwriter".

Why then after providing the documentation and guidelines that we relied on to evaluate each case file is the OIG's interpretation of HUD guidelines given more consideration than the direct endorsement underwriter. Why then am I being asked to reimburse HUD \$154,921 in claims and fees and indemnify 12 loans in the amount of \$1,605,950.

Furthermore the most serious recommendations made by the Office of the Inspector General as a result of their audit was, "That the assistant secretary for the federal housing commission require United Mortgage reimburse HUD for claims and fees paid on one loan amounting to \$154,921".

Comment 2

Since becoming a Direct Endorsement Lender in 1992 HUD has never incurred a loss on any loans originated by Unite Mortgage Corp. While there was indeed a claim paid on this loan, the type of claim was not a "01 Conveyance" where the asset became part of HUD's real estate owned (REO), but rather a "02" Accelerated Claim" under the "Accelerated Claim and Asset Disposition Program" or "ACD" Program.

This new legislation allows HUD to pay insurance claims on, and dispose of, defaulted single-family mortgage loans. "Specifically to pay a claim upon assignment rather than upon conveyance of the property; and transfer assigned mortgage loans to a Joint Venture for servicing, restructuring, foreclosure, property management, asset disposition and other disposition alternatives.

The ACD program goals are as follows:

- Resolve defaulted assets by aligning private sector interest with FHA.

- Reduce HUD's participation in the REO business.

- Increase the value of single-family assets and recovery to FHA.

- Produce savings to FHA.

So while a claim has been "paid" on this case there were no losses incurred by HUD. The OIG's request for United Mortgage to reimburse HUD for the "claims and fees" is analogous to paying damages that have not yet occurred and furthermore may never occur. The fundamental solution in this joint venture is to put the borrower back on a repayment schedule and save the home from foreclosure proceedings.

Furthermore, this loan had been prudently underwritten in accordance to HUD guidelines.

After thoroughly considering of all the facts and circumstances surrounding the audit findings of this loan, the only conclusion that could be drawn regarding the auditors request for reimbursement is simply because the loan has gone into default.

The auditors finding in this case, is not based on factual information or an understanding of HUD requirements. Furthermore the OIG considered their finding that the "appraisal report was not adequately reviewed" a grave enough breach of HUD guidelines as to seek reimbursement for the ACD claim "paid" by HUD.

Appraisal Report Was Not Adequately Reviewed

The auditors stated that there was no evidence that United Mortgage questioned the appraised value of the subject property to determine whether or not the appraiser's conclusions were acceptable as required by HUD Handbook 4000.4 REV-1. The subject property sold for \$52,500 on October 24, 2003. The appraised value was \$147,500 and the auditor has stated that this was a 181% increase in value over a six-month period. The OIG further states that the appraisal report did not provide sufficient information to justify and substantiate a large increase in value.

Comment 5

The following are the facts as documented in the file:

The appraiser stated on page 1 that the property was in the process of being renovated and was in good condition. What the auditor has neglected to state is that the appraiser included five interior photos of the subject property, which clearly depicted the scope of the renovation. The appraiser further stated the following in his addendum: "In preparing for the appraisal assignment, the appraiser has performed the following analysis and actions necessary to obtain sufficient information in order to arrive at a supportable and defensible estimate of market value for the subject property. The subject property was visited and pictures were taken, **improvements were examined and measured and a thorough inspection of the site, improvements and location was analyzed.** Other considerations were given to the neighborhood, surrounding properties, schools, police and fire protection and other support facilities. The final estimate of value and conclusions enclosed in this report is based on available market data, the appraiser's knowledge, experience, training, and accepted appraisal methodology." Furthermore, the underwriter ordered a final inspection of the property, even though the second appraisal, as required by Mortgagee letter 2003-07, showed the satisfactory completion of the property.

The first appraisal performed by [REDACTED] dated 03/27/2004 was used for the basis of the underwriting decision since it was the more conservative of the two and also required a re-inspection of the property. A second appraisal was obtained in accordance with Mortgagee Letter 2003-07. This appraisal was dated 04/18/04 and was performed by HUD approved appraiser [REDACTED]. Although consideration was given to this report, it was not the "accepted" appraisal as incorrectly stated by the OIG. The auditors also incorrectly stated that comp one appraised at \$150,000 on April 18, 2004. This property did not appraise for \$150,000, it sold for \$150,000. The actual appraised value was \$148,450. Again, this second report was not the final basis for the decision, and was merely in accordance with Mortgagee letter 2003-07 to **further support** the value. The auditor has stated that the deficiency of "inadequate review of the appraisal" should have precluded approval of this loan. Two separate HUD appraisers, the DE underwriter, a review appraiser and an AVM all concluded that the value was acceptable and supported. Handbook 4004.04 rev 1 Paragraph 3-3G states "upon completion of the review, if the underwriter has no comments or corrections to make to the appraisal, then HUD form 54113 will be sufficient evidence of the underwriter's review of the appraisal report", this form is contained in the case file.

What the OIG neglected to state is the following:

- ❖ Ratios of 19.16/29.00
- ❖ Excellent job stability – 22 yrs for borrower and 6 yrs for co-borrower
- ❖ 19 months in cash reserves
- ❖ 2nd job was documented but not used to qualify (if 2nd job was used ratios would have been 17.07/25.83)
- ❖ First time homebuyers. Co-borrower is a minority.

Comment 5

United Mortgage strictly adhered to HUD's established protocol to insure the department's interest in the property. The documentation contained in our file clearly and concisely proves that United was in full compliance with HUD directives and exercised due diligence in the underwriting and origination of this loan.

Inadequate or Incomplete Compensating Factors

"HUD Handbook 4155.1, Rev-4, paragraphs 2-12 and 2-13 provides that the borrowers total mortgage payment to effective income ratio and total fixed payment to effective income cannot exceed 29 percent and 41 percent respectively without listing significant compensating factors".

Response:

Over the course of the last seven months, the auditors for the Inspector General's Office and United Mortgage have spent countless hours in debate of the compensating factors used by United for cases where ratios have exceeded HUD's benchmark guidelines. United had repeatedly documented the underwriter's justification however the auditor's still felt the necessity to broaden the scope of the audit to include 16 additional files specifically to review compensating factors.

While the auditor's may have disagreed with the underwriter's evaluation and judgment of the questioned mortgage loans United was able to prove that there was no basis for the negative view of the underwriting decisions nor did the loans have the credit deficiencies noted in the audit findings.

Per the OIG Audit Report on "FHA Case File Review" dated May 15, 2003 Finding 1 page 3 "HUD Handbook 4155.1 REV-4 CHG-1 provides rules and guidance for credit approval. The rules are very flexible and are often stated in subjective terms, relying on the judgment of the underwriter to determine credit worthiness. Additionally per HUD Handbook 4155.1 REV -5 Section 5 "As evidenced by the description of compensating factors, ratios can be exceeded when significant compensating factors exist. We do not set an arbitrary percentage that ratios may never be exceeded; however, the underwriter should judge the overall merits of the loan application and determine what compensating factors apply and the extent to which the ratios may be exceeded. Each loan is a separate and unique transaction and there may be other factors that demonstrate the borrower's ability and willingness to make timely mortgage payments. United has also relied on HUD Handbook 4155.1 REV-4, CHG-1 Appendix 1: Questions and Answers Number 18 that the underwriter is not limited to the eight compensating factors "Each loan is different and there may be substantial compensating factors present not included in the list of normal, acceptable compensating factors". Lastly HUD Handbook 4000.4 Rev1 1-5 "The Department's mortgage insurance programs are designed to serve the credit needs of those homebuyers not adequately served by the private sector. Processing cases under the Direct Endorsement program should not result in lesser considerations of applications involving marginal locations, properties or credit risks. The program provides mortgagees the necessary assurance of endorsement since subjective underwriting determinations are reviewed only after the mortgage has been endorsed".

Comment 6

Comment 6

Comment 6

Direct Endorsement Lenders have assurances from HUD that the underwriter's evaluation will be supported provided underwriting guidelines have been adhered to. Regardless of the auditors arbitrary disqualification of the factors used, United was able to justify and provide the applicable documentation for mortgage qualification in each of the loans questioned.

251-3042694

Minority Borrower
First Time Homebuyer

The auditor stated that the borrower had a mortgage payment expense to effective income ratio of 37.04% and a total fixed payment to effective income ratio of 45.25%. United used "conservative use of credit, good earning potential and that overtime or bonus income were not used to qualify as compensating factors.

The auditor discounted "the conservative use of credit" as a viable factor as a "credit line had been opened within three months prior to closing and that the balance on that line was close to its allowable limit" we disagree with the auditor's opinion. In determining a conservative use of credit the measurement is not the outstanding balances on the debts but the dollar amount of recurring monthly expenses. The same number one would use in calculating ratios to qualify a borrower. In this case, the borrower had only two trade lines one being a student loan with a monthly payment of \$159.00 and a line of credit with monthly payments of \$62.00 for a total recurring monthly expense of \$221.00.

Although given a lesser value by the underwriter the borrower did have the potential for increased earnings as evidenced by the verification of employment, which showed steady increases in income. The open student loan that was reflected on the credit report indicated she had received additional education. The third factor listed on the 2900 worksheet was additional income that was not used to qualify the borrower. Although the effect of this income was minimal, this additional income was considered by the underwriter in her overall analysis of the file. HUD does not provide specific guidelines regarding how much of an impact additional income must have to be considered in qualifying a borrower. The auditor felt that this additional bonus income could not be used as a compensating factor as there was "no evidence that the overtime and bonus income was likely to continue". That is the very reason why United did not use those numbers in the calculation of effective income but rather as compensating factor. As per HUD Handbook 4155.1 REV-4, CHG-1 Appendix 1: Questions and Answers Number 18 the underwriter is not limited to the eight compensating factors "Each loan is different and there may be substantial compensating factors present not included in the list of normal, acceptable compensating factors". In addition to the above, some additional consideration was given to the fact that the borrower had conventional FICO scores of 600/619/648 respectively and had the loan request not have been at 97% loan to value the file could have easily been qualified under Fannie Mae guidelines.

Comment 7

Comment 8

374-4236831

Underserved Area

First Time Homebuyer

The underwriter did not list the compensating factor on the 2900 worksheet. This was an inadvertent error and considered a Level One Deficiency. It is the opinion of the Quality Assurance Division that "as long as compensating factors exists in the credit underwriting package they may be relied upon when reviewing the underwriter's credit decision". United had documented that the borrower had substantial cash reserves after closing in excess of six months PITI (principal interest taxes and insurance). In addition, the borrower had FICO scores of 656/672 and 616 respectively. Had the loan not been a 203K rehabilitation mortgage would have qualified under conventional mortgage guidelines. In addition, the loan to value after the improvements to the property was 80%.

371-3362145

First Time Homebuyer

Minority Borrower

Also did not have the compensating factors listed on the 2900 worksheet. However, there were numerous compensating factors that were weighed by the underwriter in granting mortgage approval. This mortgage was given to a "first time homebuyer" a single mother, a minority borrower purchasing a modest 2 bedroom 1 bath home who was working two job's to support herself and her two children. This loan could have easily have been approved in the sub-prime arena but in keeping with HUD's mission "of providing homeownership opportunities for the underserved segment of the marketplace" United felt that this borrower certainly met that criteria.

Additional consideration was given to the fact that the borrower had over 15 years with the Mount Vernon School District. The verification of employment documented that she had steadily received pay increases and as a member of the civil service employee union her raises were contractual in nature. The auditor felt that these contractual pay raises should not have been considered as the verification of employment **"did not indicate whether there would be any pay raises in the future"**. The three year earnings history per the verification of employment dated May 2004 confirmed the borrower received past salary increases of 3.6%; 4.0% and was scheduled for a increase in July 2004 however the amount of that increase was "not available" at the time of verification. The standard industry verification document does not ask for anything more then the date of the last and the date of the next raise. That raise information and the earning history over the last three years is what is required to establish the earning trend which is acceptable by HUD and every secondary market lender. The auditor's conclusion that contractual pay raises were not applicable in this case as there was no indication of "pay raises in the future" is an unjustified criticism of the underwriter's analysis of the mortgage loan.

HUD states that "each loan is a separate and unique transaction and that there may be other factors that demonstrate the borrower's ability and willingness to make timely mortgage payments". While HUD guidelines does not allow the lender to use gift funds to meet their definition of reserve deposits, underwriters in their evaluation of any loan

Comment 9

consider “layering effects” both negative and positive. In this case the borrower had reserves in excess on four mortgage payments after closing which included \$1,756 available in her 401K and \$2,255 on deposit (after closing and the payoff of a collection account). Another part of the positive “layering effect” considered by the underwriter was that the ex husband was responsible for the \$286.00 monthly Resort debt payment. United was able to obtain proof of one monthly payment as the ex husband would not cooperate in supplying the necessary 12 month history therefore the debt had to be included in the ratios.

374-4347581

Underserved Area

First Time Homebuyer

The underwriter used “contractual pay increases, conservative use of credit and good earnings potential as compensating factors. The borrower was employed by the Manhattan Transit Authority and as such had to be a member of the transport workers union and civil service employee. The payment of union dues was also indicated on the pay-stubs. All employees of the MTA receive increases based on agreements reached by union contract negotiations. There is no justification for the auditor’s criticism of the underwriter’s use of contractual pay increases as a compensating factor. Furthermore 4155.1 REV 5 Section 5 states that the “underwriter should judge the overall merits of the file and determine what compensating factors apply and the extent which ratios may be exceeded”. United’s underwriter’s also utilized the borrower’s conservative use of credit in the qualifying analysis as the monthly recurring expenses were only \$470.95. Once again per HUD Handbook 4155.1 REV-4, CHG-1 Appendix 1: Questions and Answers Number 18 the underwriter is not limited to the eight compensating factors listed in the Handbook “Each loan is different and there may be substantial compensating factors present not included in the list of normal, acceptable compensating factors”. The underwriter deviated from the standard “compensating factors” as HUD does not limit what factors can be used in the underwriters justification of exceeding the benchmark ratios. The underwriter’s also used “good earning potential” as a factor that was considered for the approval as the borrower’s total income for the year ending 2003 totaled \$65,401 and on the year to date pay-stub of 12/2003 the borrower’s total earnings were \$70,907. It must also be noted that the co-borrower was employed as a cook for a pizzeria however due to the nature of that business United could not verify the income.

The OIG has also requested that HUD review an additional 7 active case “with deficient compensating factors to determine whether they should have been approved”. Due to time constraints listed below is a brief description of the compensating factors used in the qualification of these loans. A more detailed analysis and the applicable documentation will also be available at a later date.

Comment 10

Comment 11

371-3355512

First Time Homebuyer.

Minority Borrower.

FICO Scores 684/647/683.

The borrower had 3.94 months of reserves on deposit after closing. Although the monies were received as part of the gift 4155.1 REV4 did not preclude gift monies being used a cash reserves.

The borrower also used credit conservatively as she had a student loan payment of 25.00 per month and 3 credit cards with a total monthly payment of \$75.00.

Comment 12

351-4593484

First Time Homebuyer.

Ratios 29.81/46.8.

Over 11 months reserves in 401k account. The borrower had FICO scores of 614/682/610. The borrower was also employed as a correction officer with the Department of Justice for over 6 years.

Comment 13

371-3356599

Underserved Area

No Cash Out Refinance.

The monthly payment on the FHA mortgage reduced the borrowers housing expense from \$1,021.75 to \$866.09.

Borrower's ratios were 15.6/46.06.

Comment 14

292-4475818

Minority Borrower.

Ratios 31.8/46.2 FICO Scores 624/650/672.

The borrower was a previous homeowner with an exemplary payment history. Her monthly mortgage payment was only increasing \$185.03 per month.

Conservative use of credit; one car loan payment of \$246.00 per month and a student loan payment of \$76.00.

Comment 15

371-3401203

Minority Borrower.

Underserved Area.

First Time Homebuyer.

The borrower had in \$11,643.56 in reserves after closing; a car loan of \$329.00 per month and credit card payment of \$43.00. This demonstrated ability to accumulate savings and a conservative attitude towards credit

Comment 15

371-3401203

Underserved Area.

There was only a minimal increase in the borrowers housing expense. The existing mortgage payment \$690.00 and the FHA mortgage loan payment was \$705.72 resulting in an increase of \$15.72. There were no late payments on the previous mortgage payment history.

Comment 16

052-3495166

First Time Homebuyers.

The borrower had over \$6,000 in overtime income in 2002 and over \$5,800 in overtime income for 2003 that was not used in the ratios. In addition the co-borrower had a second job verified in the credit file by 1099 a pay-stub that was also not used to qualify.

The Borrower Did Not Re-Establish Good Credit Following Bankruptcy.

The auditor stated that "HUD Handbook 4155.1 REV-4, CHG -1, paragraph 2-3 E states that a bankruptcy will not disqualify a borrower from Federal Housing Administration's insurance if at least two years have passed since the bankruptcy was discharged and the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs".

Response:

Actually the full statement in the above referenced guidelines is that the borrower "must have re-established good credit **or chosen not to incur new credit obligations**. The borrower also must have demonstrated a documented ability to responsibly manage his or her financial affairs.

Comment 17

371-3330273

First Time Homebuyers.

HUD Handbook 4155.1, REV 4, CHG 1, Paragraph 2-3 states that "A bankruptcy (Chapter 7 liquidation) will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged **and** the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs". In this case the borrowers had established four new accounts with a total outstanding balance of \$22,568.00. The borrowers had an exemplary credit history and had successfully managed those debts over a two year period. The auditor stated that the borrowers "had been delinquent on a utility account and a revolving account subsequent to the bankruptcy" and that "United Mortgage did not provide an adequate explanation regarding the derogatory credit issue that occurred subsequent to the bankruptcy". These first time homebuyers provided a lengthy explanation regarding their credit circumstances detailing amongst other problems that he had been out on "workman's compensation for almost 2 years".

The derogatory accounts referred to by the auditor of a credit line (with a high credit of only \$999.00) which had a zero balance and was "closed by the consumer" and a \$261.00 collection account from a cable company. Under HUD's definition of derogatory credit and in the underwriters evaluation these account were considered "minor" in nature and certainly not enough to deny the borrower the privilege of home ownership.

371-3372063

The auditor stated that the borrower opened "11 new credit lines" had a "\$35,279 credit limit an incurred \$30,838 in debts". Actually the borrower had opened 10 credit lines with unpaid balances of \$14,472 and the remaining balance of \$16,366 was a car loan. This auditor's statement distorted the facts and inferred that the borrower had "maximized" the limits on the credit cards. Out of the 11 new accounts established after the bankruptcy one account went 30 days late in February 2002 (two years prior to closing) and this delinquency was considered minor in nature.

At the time of approval, there were 29 first and 47 second mortgage payment made without lateness. The "rolling" late payments on the first mortgage were adequately explained by the borrower's.

The auditor also commented that "for each of the borrowers there was no indication from the files that they re-established good credit nor demonstrated an ability to manage their financial affairs".

The following is a breakdown of the payment history on the account that had been established after the bankruptcy:

Long Beach Acceptance - 18 perfect payments.

Cap 1- 19 perfect payments.

Providian - 26 perfect payments.

Cap 1 - 18 perfect payments.

Cap 1 - 36 perfect payments.

Cap 1 - 26 perfect payments

Cap 1 - 3 perfect payments.

Kay Jewelers - 12 perfect payment.

Cap 1 - 15 perfect payments.

Target - 5 perfect payments.

Cap 1 - 35 perfect payments.

371-3129664

Underserved Area.

The auditor stated that the borrower failed to "establish good credit after a bankruptcy".

Please see the credit report showing a ■■■ Bank car loan in the amount of \$13,470.00 opened after the bankruptcy. Furthermore the account reflected a perfect payment history. This loan closed in February 2003, six years after the borrower filed for chapter 7 bankruptcy. Not only was this loan made in an underserved area but the borrower had 16 months in reserves after the closing, a loan to value of 83% and employed 7 years with the current employer. While we agree with the auditor that there were some late

Comment 18

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payments after the bankruptcy, these late payments occurred almost 5 years after the bankruptcy and were not judgments, charge offs or collection accounts but were "minor" in nature. In addition these accounts (per our commitment) had to be paid and satisfied at the time of closing.

Inadequate Income Verification.

HUD Handbook 4155.1 REV-4, CHG -1, paragraph 2-6 provides that the anticipated amount of income and the likelihood of its continuance must be established to determine a borrower's capacity to repay mortgage debt. In addition the lender is required to verify the borrower's employment for the most recent two years.

Response:

374-4347581

First Time Homebuyers

Underserved Area

The auditor states that "United Mortgage indicated that the borrower's gross monthly income was \$6,096.70. However based on the documents in the files we calculated it to be \$5,679.55. This change increased the total fixed payment to income or backend ratio to 47.07% which is in excess of HUD's threshold".

At the time of underwriting, the Metropolitan Transportation Authority had negotiated a new contract, the result of which was reflected in the borrower's pay-stubs showing an increase in earnings from \$23.39 to *\$24.10 per hour. Using this increase in pay we were able to indicate the borrower's earnings potential for 2004.

The auditor's calculation of the borrower's base pay was totally inaccurate. Paid holidays, vacation and sick time are broken down separately on the borrowers final pay stubs. Since the borrower is entitled to sick, holiday and vacation pay, regardless of any overtime worked, it was rightfully included in his base pay.

Recalculating the borrower's income including his new hourly earnings, including sick and holiday time, results in a monthly base income even higher than the underwriter's initial calculation of \$4,056 per month.

By using the borrowers pay stubs, is determined that the number of annual regular compensated hours was 2,200.09. At the new pay rate of \$24.10 the new calculation results in a monthly base salary of \$4,418.

By removing hours previously counted as overtime or other income, without applying the new pay rate and adding it to 2002 other and overtime earnings, the underwriter's calculation for this income would be reduced to \$1,697.00. However the total monthly income would be \$6,115.00. This is actually higher than the earnings indicated on the Mortgage Credit analysis by \$18.30 per month.

* We have also obtained written verification from New York City Transit that the salary increase was actually \$25.84 per hour.

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351-4605626

First Time Homebuyer

Underserved Area

Per the verification of employment in the file the borrower had been employed in his current position from 12/06/2002 through 4/12/2004. We have also obtained a verification of prior employment showing his employment history in the same line of work from 2/26/2001 through 11/5/2002. In addition we did have copies of two years tax returns and the 2003 W-2s in the file and the borrower's employment history was also stated on the credit report.

The co-borrowers prior verification of employment had an obvious date error and was resent for confirmation. Although the co-borrower was only one month on the job when the loan was underwriter the previous employer affirmed that she had been employed from 11/25/2002 through 3/2004 for a total history of 18 months. We also have obtained verification of her employment from 3/14/2002 through 8/11/2002. The small "gap" in employment as stated by the co-borrower was due to her pregnancy.

291-3251765

The auditors stated that United Mortgage Corp failed to verify the borrower's employment for the most two full years and that the borrower had only eight months of employment verified. In addition, the auditors stated that **"there wasn't any documentation to support the time frame or the amount of income generated"**.

Proof verifying a two-year history for both borrowers was included in our case file and was submitted to the auditors for their consideration. The borrower's employment history had been verified by a direct written verification of employment showing a current work history for a nine month period. Prior to the current position the borrower had been self employed since 2001 which was verified by the following documentation:

1. Copy of the Missouri Retail Sales License" dated 4/24/2001 showing that the borrower had been self employed as "Wooden Things".
2. Copy of two 2002 W-2 forms from the "Joplin Flea Market" where the borrower had sold the goods made from the business of "Wooden Things".
3. Letter from the borrower explaining that the business had failed and that the State of Missouri had placed a lien for non-payment of quarterly taxes.
4. Copy of letter of dismissal from the State of Missouri Director of Revenue vs. [REDACTED] stating that there was no longer a dispute between the two entities.

The co-borrower's employment history had been adequately verified for a two year period.

The auditor quotes HUD Handbook 4155.1, Rev-5, paragraph 2-9 stating that "income from self-employment is considered stable and effective if the borrower has been self employed for two or more years".

Self employment income was not included to calculate the borrower's effective monthly income therefore there was no need to **"support"** that income. The income ratios on this file were 20.4% and 37.6% based on the current income of both borrowers.

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The auditor also raised the exception that "United failed to verify the borrower's employment for the most recent two full years". Per HUD Handbook 4155.1, Rev-5. Paragraph 2-6 HUD also states that they "do not impose a minimum length of time a borrower must have held a position to be eligible". Although the borrower had only 9 months on the current job he was able to prove in excess of a two year work history by proving proof of self employment

Questionable Documents

HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3C requires that judgments must be paid off before the mortgage is eligible for endorsement. Also HUD Handbook 4155.2, REV-4, paragraph 2-11C states that if a debt payment, such as a student loan is scheduled to begin within twelve months of the mortgage loan closing the lender must include the anticipated monthly obligation in the underwriting analysis unless the borrower can provide evidence that the debt may be deferred to a period outside this timeframe.

Response:

374-4347581

First Time Homebuyer
Underserved Area

The auditor stated that the case file had "two letters explaining judgments totaling \$4,876 had been satisfied. Each of these letters was provided to United Mortgage via facsimile and had incomplete header information. However the files did not contain evidence of reverification of these letters, nor the source of the payment that satisfied the judgment". United obtained an explanation from the borrower and requested proof that the judgments were satisfied. In addition, the underwriter's condition requiring source of funds was requested in anticipation of the judgments being satisfied prior to closing. Since the judgments were satisfied some time prior to the initial application, the condition was rendered unnecessary. These items were received via fax; however they were not relied upon in satisfying the condition related to the judgments. Although it is United's policy to verify the authentication of faxed documents, the underwriter did not feel it was essential since most emphasis was placed on the subsequent receipt and review of the title insurance policy, which evidenced no judgments. The primary reason for satisfaction of judgments is to ensure a valid and enforceable lien on the subject property. In view of the fact that the title insurance company provided clearance of these judgments, which concurred with the documentation in the file, no further re-verification or documentation was deemed necessary.

I would also like to add that United was instructed not to make contact with the borrowers regarding the "letters" in the file as it would "interfere with the OIG investigation". After we received the final report issued by the OIG we did in fact try to contact the borrowers. When they would not reply to our phone calls we had a staff member bring a letter asking them to contact us.

In our conversations with the borrower she claimed that she had been told in her phone interview that "her conversation was being recorded" and was asked if the down payment

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monies were obtained "by drug money". To this day she claims she will not answer her door as she was so frightened by these accusations.

I brought these incidents up at the "exit interview" and the OIG auditor denied that this had taken place during his interview. However he did indicate that this file had been "referred" to another agency. I also want to comment on the statement the auditor made that "United Mortgage's president felt that based on the responses in the letter, the judgments of \$4,876 were not significant to require additional follow-up". That statement was in response to a general question regarding judgments from previous landlords in rental situations and was not a response to the specific documentation in this file.

061-2722023

First Time Homebuyer

Underserved Area

In his comments the auditor stated that "The file contained questionable debt verification" and "The student loan provider indicated that the loans became due shortly after closing. Thus the debt should have been included as part of the analysis of the borrowers liabilities".

The auditor's "discovery" of the change in the status of the borrower's student loans was based on the credit report pulled in United's quality control review in January 2005 some 15 months after the credit report used in to qualify the borrower dated 10/2003. The January 2005 report indicated that the payment of the student loans had changed from deferred to a repayment status. The auditor also obtained written re-verification of the loans status from Sallie Mae in May 2005 which was backdated at his request to November 12, 2003 the date of the loan verification United used to qualify the borrower seventeen months earlier.

At the time the auditor presented the verification letter he obtained sometime in May 2005 he made allegations that the Sallie Mae verification document had been altered. Thus arriving at his conclusion that "United Mortgage failed to properly verify the documentation that would have led to questioning the reliability of the debt verification documentation".

When comparing the two verification letters the difference is the "**anticipated** graduation dates". United's verification letter stated a graduation date of 8/30/2004 and the auditors backdated letter stated 8/30/2003 each verification showed loan repayment beginning six months after graduation. In contacting Sallie Mae we confirmed that they received graduation information from **two schools** which would explain the inconsistencies in the two letters.

When United was given the results of the auditors backdated verification document sometime in June 2005, United immediately contacted Sallie Mae and once again ascertained that these loans were not in repayment even as of that date. This relevant information was given to the auditor who chose not to pursue it or give any consideration. Since that time United has obtained additional written confirmation from Sallie Mae verifying that repayment on the student loans would not begin until 10/10/2005.

United prudently analyzed the borrower's liabilities using the verification letter from Sallie Mae which also coincided with the deferred status of the student loan repayment as indicated in the 10/2003 credit report. Underwriting is an analysis of information of a

Comment 24

“snapshot in time” and the underwriter’s evaluation of these liabilities was based on the information and documentation as of October 2003. The auditors comments were based on information obtained almost a year and a half after the underwriters review and analysis of the mortgage request. Furthermore United has repeatedly confirmed the accuracy of the information used in the qualification of the borrower. The auditor placed undue emphasis in his insinuating comments regarding the accuracy of the documentation which had to be vigorously defended by United. However even using the repayment terms as stated by Sallie Mae of \$171.89 per month the payment to income ratio went from 38.01 to 41.5%. The auditors comment that the “impact of this debt to the borrower’s ratio’s would have required significant compensating factors” implies that the terms of repayment for the student loans would have had a substantial impact on the ratios is erroneous. Furthermore should a compensating factor have been necessary to approve the loan the borrower had three months in reserve deposits available after closing.

Inadequate Debt Verification

HUD Handbook 4155.1, REV-4, paragraph 2-11C states that the borrower’s liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense, and all other additional recurring charges including payments on installment accounts, child support, or separate maintenance payments, revolving accounts and alimony, etc., extending ten months or more.

Response

061-2722023

First Time Homebuyer
Underserved Area

The auditor stated “that the borrower had numerous inquiries on her credit report however United Mortgage did not require the borrower to explain the inquiries that were on the report. These credit items were significant because the quality control review performed in this loan found that a liability that was incurred between the application and the closing that was not included in the approval of the loan.

United always obtains an explanation of the borrowers inquiries, it is standard language in the mortgage loan commitment. The only explanation that can be offered is that the file had been handled by so many individuals that perhaps the explanation letter was lost. Also there was no mention in the results of the quality control review performed by an outside contractor that United did not obtain an explanation if the inquiries made within 90 days as required by HUD guidelines. report”.

The auditor has based this finding on a credit report run 15 months after the report used to qualify the borrower. There **was no credit inquiry from Credit Acceptance on the credit report dated 10/20/2003**, the date of the report used to underwrite the application. The auditor is trying to establish some correlation between the absence of the credit

Comment 25

The auditor is trying to establish some correlation between the absence of the credit explanation letter and the loan taken out 12/2003. Per 4155.1 REV-4 3.2 "Credit documents may be up to 120 days old at the time the loan closes" establishing the date of United's report well within the 120 day tolerance. No secondary market investors including Fannie Mae, Freddie Mac and even most sub prime lenders require that credit documents be updated prior to closing. The auditor's suggestion that United somehow should have known about this loan and included the monthly payment in the qualifying ratios is without merit.

091-3646170

Minority Borrower

First Time Homebuyer

The borrowers credit report dated October 04, 2002 shows the account in question, a car loan through [REDACTED] had as of August 2002 had 48 payments paid on the account.

The borrower's credit union bank statements reflect that the borrowers account was debited on 9/5 for a WFS "fee and payment" amount of \$320.00 and an ACH debit #109447 in the amount of \$310.00 paid 10/03. Therefore the loan payment did have to be included in the borrower's ratios.

Inadequate Appraisal Review

Mortgagee Letter 03-07 states that if a home's resale date is between 91 and 180 days following acquisition by the seller, the lender is requested to obtain a second appraisal made by another appraiser if the resale price is 100 percent or more over the price paid by the seller when the property was acquired. As an example, if a property is re-sold for \$80,000 within six months of the seller's acquisition of that property for \$40,000, the mortgage lender must obtain a second independent appraisal supporting the \$80,000 sales price. The mortgage lender may provide documentation showing the costs and extent of rehabilitation that went into the property that resulted in the increased value; however, the lender must still obtain the second appraisal.

Response

351-4605626

First Time Homebuyer

Underserved Area

The auditor's unsubstantiated comments and conclusions are without merit; furthermore the basis for his conclusion should have been stated in the findings. These findings seem to be based on the "gut feeling" of the auditor rather than his familiarity with this area. Can the auditor definitively state that an increase in value of 27%, with major improvements to the property, is not feasible? If so I would think in his critique of the appraisal he should have specifically defined what additional information he felt was needed "to justify and substantiate a large increase in value".

The statement that the "mortgage lender may provide documentation showing the costs and extent of the rehabilitation that went into the property that resulted in the increase in

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value". Yes that would have been nice, but HUD does not require any more documentation than what United submitted in the case file.

The appraiser stated in the body of the appraisal that "the home had been renovated within the last year" the appraisal was also provided a supplement showing that the following renovations had been made:

1. New kitchen cabinets, countertops, flooring, appliances.
2. New bathroom flooring, toilet, tub, wainscot.
3. All interior walls were painted.
4. New interior floor coverings.

The appraiser also noted that "the subject property is located in an area where the residential market has shown a steady increase in market values over the last two years. This is due to a low inventory of available homes combined with low interest rates. This Market has been referred to as a "sellers market" by real estate professionals".

In our meeting with the auditor in May where he expressed his concerns with the property United immediately ran an "Automated Valuation Module" of the subject property. The value of the AVM **is based solely on comparable sales and does not take the property improvements into consideration.** The value at that time was \$119,940.00 and increase of an additional 11.7% without taking the properties improvements into consideration. This information was given to the auditor however it was not given any consideration.

371-3386266

First Time Homebuyer

The auditors stated that there was no evidence that United Mortgage questioned the appraised value of the subject property to determine whether or not the appraiser's conclusions were acceptable as required by HUD Handbook 4000.4 REV-1. The subject property sold for \$52,500 on October 24, 2003 the appraised value was \$147,500 on April 18, 2004. The auditor's stated that this was a 181% increase in value over a six month period. The OIG further stated that the appraisal report "did not provide sufficient "information to justify and substantiate a large increase in value and United Mortgage did not question the values". The appraiser stated on page 1 that the property was in the process of being renovated and was in good condition. What the auditor's neglected to state is that the appraiser included five interior photos of the subject property, which clearly depicted the scope of the renovation. The appraiser further stated the following in his addendum: "In preparing for the appraisal assignment, the appraiser has performed the following analysis and actions necessary to obtain sufficient information in order to arrive at a supportable and defensible estimate of market value for the subject property. The subject property was visited and pictures were taken, **improvements were examined and measured and a thorough inspection of the site, improvements and location was analyzed.** Other considerations were given to the neighborhood, surrounding properties, schools, police and fire protection and other support facilities. The final estimate of value and conclusions enclosed in this report is based on available market data, the appraiser's knowledge, experience, training, and accepted appraisal methodology." Furthermore United's underwriter ordered a final inspection of the property, even though the second appraisal, as required by Mortgagee letter 2003-07, showed the satisfactory completion of the repairs to the property.

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The first appraisal, performed by [REDACTED], was dated 03/27/2004. This appraisal was used for the basis of the underwriting decision since it was the more conservative of the two and also required a re-inspection of the property. A second appraisal was obtained in accordance with Mortgagee Letter 2003-07. This appraisal was dated 04/18/04 and performed by [REDACTED]. Although consideration was given to this report, it was not the "accepted" appraisal as incorrectly stated by the OIG.

The auditors state that United did not question comp one, which sold for 60,000 on January 17, 2003 and stated that the appraised value was \$150,000 on April 18, 2004. This property did not appraise for 150,000, it sold for \$150,000. The actual appraised value was \$148,450. The underwriter did not question this because this second report was not the final basis for the decision, and was merely in accordance with Mortgagee letter 2003-07 to **further** support the value.

The auditor's stated that the deficiency of the "inadequate review of the appraisal" should have precluded approval of this loan. Two separate HUD appraisers, the DE underwriter, a review appraiser and an AVM all concluded that the value was acceptable and supported. Handbook 4004.04 rev 1 Paragraph 3-3G states "upon completion of the review, if the underwriter has no comments or corrections to make to the appraisal, then HUD form 54113 will be sufficient evidence of the underwriter's review of the appraisal report" This form is contained in the file.

Narrative Case File Responses

Case Number 374-4347581
Loan Amount \$275,650
Settlement Date: January 30, 2004

A. Questionable Documentation

The auditor states that the file contained questionable judgment verifications. HUD Handbook 4155.1 REV-4 CHG-1 Paragraph 2-3C requires that judgments must be paid off before the mortgage loan is eligible for endorsement. United is fully aware of this requirement. United obtained an explanation from the borrower and requested proof that the judgments were satisfied. In addition, the underwriter's condition requiring source of funds was requested in anticipation of the judgments being satisfied prior to closing. Since the judgments were satisfied some time prior to the initial application, the condition was rendered unnecessary. These items were received via fax, however they were not relied upon in satisfying the condition related to the judgments. Although it is United's policy to verify the authentication of faxed documents, the underwriter did not feel it was essential since most emphasis was placed on the subsequent receipt and review of the title insurance policy, which evidenced no judgments. The primary reason for satisfaction of judgments is to ensure a valid and enforceable lien on the subject property. In view of the fact that the title insurance company provided clearance of these judgments, which concurred with the documentation in the file, no further re-verification or documentation was deemed necessary.

B. Inadequate Income Verification and the Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

4155.1 Section 5 states: As evidenced by the description of compensating factors, ratios can be exceeded when significant compensating factors exist. We also do not set an arbitrary percentage that ratios may never exceed; however the underwriter should judge the overall merits of the loan application and determine what compensating factors apply and the extent to which ratios may be exceeded.

Although there were no contractual increases listed on the employment verification, the borrowers pay history has demonstrated a continual increase in earnings. The 2001 partial year income was \$57,397 when annualized, while 2002 and 2003 were \$65,401.33 and \$70,907.72 respectively.

In addition, it was known at the time of underwriting, through the new media reports and spouse of one of our employees, that the Metropolitan Transportation Authority had recently negotiated a new contract. As a result, the borrower's pay stubs in the file show an increase in earnings from \$23.39 to *\$24.10 per hours. This increase in pay is enough to indicate the borrower's earnings potential for 2004.

The auditor's calculation of the borrower's base pay was totally inaccurate. Paid holidays, vacation and sick time are broken down separately on the borrowers final pay

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stubs. Since the borrower is entitled to sick, holiday and vacation pay, regardless of any overtime worked, it was rightfully included in his base pay.

Recalculating the borrower's income including his new hourly earnings, including sick and holiday time, results in a monthly base income even higher than the underwriter's initial calculation of \$4,056 per month.

By using the borrowers pay stubs, is determined that the number of annual regular compensated hours was 2,200.09. At the new pay rate of \$24.10 the new calculation results in a monthly base salary of \$4,418.

By removing hours previously counted as overtime or other income, without applying the new pay rate and adding it to 2002 other and overtime earnings, the underwriter's calculation for this income would be reduced to \$1,697.00. However, the total monthly income would be \$6,115.00. This is actually higher than the earnings indicated on the Mortgage Credit analysis by \$18.30 per month.

* We have also obtained written verification from New York City Transit that the salary increase was actually \$25.84 per hour.

Case Number: 061-2722023
Loan Amount: \$164,900
Settlement Date: January 9, 2004

The initial cause of the delinquency on this loan was due to the mortgage loan servicer returning the borrower payments as documented in our credit file. Numerous conference calls were made between United the mortgage loan servicer and the borrower in an attempt to correct this situation. Due to the servicing errors the mortgage appeared as defaulted on Neighborhood Watch which prompted United to perform a quality control review in accordance with FHA guidelines. The majority of the auditor's findings are based on the quality control review of the file performed some 15 months after loan approval.

A. Questionable Documentation

In his comments the auditor stated that "The file contained questionable debt verification" and "The student loan provider indicated that the loans became due shortly after closing. Thus the debt should have been included as part of the analysis of the borrowers liabilities".

The auditor's "discovery" of the change in the status of the borrower's student loans was based on the credit report pulled in United's quality control review in January 2005 some 15 months after the credit report used in to qualify the borrower dated 10/2003. The January 2005 report indicated that the payment of the student loans had changed from deferred to a repayment status. The auditor also obtained written re-verification of the loans status from Sallie Mae in May 2005 which was backdated at his request to November 12, 2003 the date of the loan verification United used to qualify the borrower seventeen months earlier.

At the time the auditor presented the verification letter that he had obtained sometime in May 2005 he made allegations to the effect that the Sallie Mae verification document had been altered. Thus arriving at his conclusion that "United Mortgage failed to properly verify the documentation that would have led to questioning the reliability of the debt verification documentation".

When comparing the two verification letters the difference is the "anticipated graduation dates". United's verification letter stated a graduation date of 8/30/2004 and the auditors backdated letter stated 8/30/2003 each verification showed loan repayment beginning six months after graduation. In contacting Sallie Mae we confirmed that they received graduation information from **two schools** which would explain the variance in the two letters.

In addition when the auditor presented the results of the backdated re-verification document to United sometime in June 2005, Sallie Mae was immediately contacted and once again we received confirmation that these loans were not in repayment even as of that date. This relevant information was given to the auditor who choose not to pursue it give it any consideration.

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Since that time United has obtained additional written confirmation from Sallie Mae verifying that repayment on the student loans would not begin until 10/10/2005. United prudently analyzed the borrower's liabilities using the verification letter from Sallie Mae which also coincided with the deferred status of the student loan repayment as indicated in the 10/2003 credit report. Underwriting is an analysis of information of a "snapshot in time" and the underwriter's evaluation of these liabilities was based on the information and documentation as of October 2003. The auditors comments were based on information obtained almost a year and a half after the underwriters review and analysis of the mortgage. Furthermore as United has repeatedly confirmed the accuracy of the information used in the qualification of the borrower. The auditor placed undue emphasis in his insinuating comments regarding the accuracy of the documentation which had to be vigorously defended. However even using the repayment terms as stated by Sallie Mae of \$171.89 per month the payment to income ratio went from 38.01 to 41.5%. The auditors comment that the "impact of this debt to the borrower's ratio's would have required significant compensating factors" implies that the terms of repayment for the student loans would have had a substantial impact on the ratios is erroneous. Furthermore should a compensating factor have been necessary to approve the loan the borrower had three months in reserve deposits available at the time of closing. The auditor commented that United did not require the borrower "as part of the conditions of the commitment to provide her college transcripts. There were no college transcripts in the file. United Mortgage explained that the underwriter waived this condition due to the fact that there was a letter from the university attesting that she had been a student through 2003. In regards to this letter United failed to question and verify it". Both United and the OIG auditor contacted the University and determined that the borrower was a student only through 2002. United interviewed the person who had compiled the information and had written the verification letter and she attested to the fact that she had made a "typo". While the accuracy of this letter should have been verified, United was aware that borrower had worked all the year of 2003 and the importance of the auditors finding must be weighed. The underwriter's only reason to condition the transcripts on the mortgage loan commitment was to establish the two year history for the borrower per HUD guidelines. The relevant information needed to complete the history was to confirm that the borrower had been in school during 2002 as she was employed throughout 2003.

B. United Mortgage Processed Loan As if the Co-Borrower Was Going To Be an Occupant.

The co-borrower, a relative of the borrower was "living with family" and had no additional housing or utility liabilities to consider in calculating the ratios. Therefore there was no impact on the qualifying ratios or any additional risk to HUD had the loan being underwritten with the co-borrow as occupying or non-occupying. Both the borrower and the co-borrower attested in more than one document of the co-borrowers intent to occupy.

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The auditor quoted that the “borrower stated that United Mortgage’s loan officer was made aware of that fact”. One must question this statement as the loan officer had no reason whatsoever to withhold this information as the mortgage qualified using either scenario.

C. Failure to Adequately Analyze the Borrower’s Credit Report.

The auditor’s first sentence that “the borrower had over 85 inquiries on her credit report” is irrelevant and is mentioned only for its shock value to the reader. HUD requires that the lender obtain an explanation of any inquiries within 90 days of the credit report which narrows down that number to 26 within the 90 days period.

The following is a recap of the inquiries:

United Mortgage	10/20
Factual Data	9/22
Guaranty Residential	9/22
Factual Data	9/22
Factual Data	9/19
Factual data	9/19
Right Track Fincl	9/18
First Franklin	9/18
Info 1-Ca	9/18
StratInfo	9/18
StratInfo	9/18
Info One	9/18
216 East West	9/17
Landsafe	9/17
Countrywide	9/17
Manch NH	9/17
Countrywide	9/17
CB of NewHampshire	9/17
Countrywide	9/17
Landsafe	9/17
RightTrackFinancial	7/8
StratInfo	7/8
Creditdata	7/8
EFXResidential	7/7
Amerianhomemrtga	7/7
Equifaxmortgageserv	7/7

Many of the inquiries were duplications from the same member number and as many as 8 inquiries were run on the same day (3 on 9/22; 2 on 9/19; 6 on 9/18; 8 on 9/17; 3 on 7/8; 3 on 7/7). These inquiries were the result of an inexperienced borrower shopping for a mortgage and allowing each potential lender to run a report.

United always obtains an explanation of the borrowers inquiries, it is standard language in the mortgage loan commitment. The only explanation that can be offered is that the file has been handled by so many individuals that perhaps the explanation letter was lost.

Also there was no mention in the quality control review that United did not obtain an explanation if the inquiries made within 90 days as required by HUD guidelines.

The auditor stated that "these credit items are significant due to the fact that the quality control review performed on this loan found that significant liabilities were incurred between the application date and the closing, which were not included in the ratios. Specifically a \$22,936 Credit Acceptance account dated 12/2003 was not shown on the initial credit report".

Once again the auditor is basing his finding on a credit report run 15 months after the report used to qualify the borrower. There was no credit inquiry from Credit Acceptance on the credit report dated 10/20/2003, the date of the report used to underwrite the application. The auditor is trying to establish some correlation between the absence of the credit explanation letter and the loan taken out 12/2003. Per 4155.1 REV-4 3.2 "Credit documents may be up to 120 days old at the time the loan closes" establishing the date of United's report well within the 120 day tolerance. No secondary market investors including Fannie Mae, Freddie Mac and even most sub prime lenders require that credit documents be updated prior to closing. The auditor's insinuation that United somehow should have known about this loan and included the monthly payment in the qualifying ratios is without merit.

The auditor also commented that the co-borrower had derogatory debt items on his credit report "The co-borrower's explanation did not adequately explain his derogatory credit". The co borrower had one \$200.00 charge off in 8/2001 that required an explanation, the underwriter accepted the co-borrowers statement that while a student his car had broken down and that he was also paying for his school supplies and text books. The time frame of the delinquency coincided with the date of the oldest student loan which had been taken out in 11/98. The explanation letter was credible giving no foundation to the auditors finding.

In addition the auditor stated that the co-borrowers credit report indicated eight student loans that were all opened a couple of months prior to the credit report being examined. United Mortgage should have requested proof that the student loans were deferred for twelve months".

The credit report reflected that the student loans had zero balances therefore the underwriter felt that did not necessitate a letter of deferral. The same student loan status showing zero balances also was reflected on the credit report that had been run as a result of the quality control review dated 1/04/2005. Further inquiries made to Sallie Mae in October 2005 showed that two loans were taken out 7/4/04 and that the next payment in the amount of \$217.00 will be due on 7/16/2006.

Case Number: 371-3362145
Loan Amount: \$118,300
Settlement Date: May 28, 2004

A. United Mortgage Did Not Establish That the Eventual Increase in Mortgage Payments Would Not Affect the Borrower Adversely.

The auditor stated that "United Mortgage did not provide evidence on whether the eventual increase in mortgage payments (when the loan reverts to the actual note rate) would affect the borrower's ability to make the mortgage payments. As such, according to HUD Handbook 4155.1 REV -5, Paragraph 2-14, United Mortgage had to document that the borrower meet one of the following criteria. The borrower must have had the potential for increased earnings that would offset the scheduled payment increases. Further, the borrower must demonstrate the ability to manage financial obligations in such a way that a greater portion of income may be devoted to housing expense. Likewise, United Mortgage should have shown that the borrower had substantial assets available to cushion the effect of the increased payments or that the cash investment made by the borrower substantially exceeded the minimum required".

As the auditor stated **only one** of the above criteria was necessary to qualify the borrower for a temporary interest rate buy-down. While the auditor quoted 2155.1 REV 5 paragraph 2-14 he neglected to complete the full eligibility statement which was applicable to the underwriting of this file:

"The borrower has a demonstrated ability to manage financial obligations in such a way that a greater portion of income may be devoted to housing expense. **This criterion also may include borrowers whose long-term debt, if any, will not extend beyond the term of the buy-down agreement**".

The highlighted portion of the above eligibility statement was the foundation used by United in meeting the eligibility criteria. A student loan, considered long term debt, with monthly payments of \$154.00 would be retired prior to the term of the buy-down agreement. A secondary reason was that the borrower had assets in excess of five months PITI "to cushion the effect of the increased payments".

Also given some consideration by the underwriter was the borrower's ability to service the mortgage debt. Using her then current income, the front ratio was 23.71% for the first year; 25.53% for the second year and 27.45% for the third year. Lastly United documented that the borrower had the potential for increased earnings having been employed for 15 years at the same place of business and consistently received annual pay increases as member of the CSEA union.

B. The Borrower's Debt to Income Ratios Exceeded the Acceptable Threshold Permitted by HUD.

The auditor stated that "the mortgage credit analysis worksheet did not list any compensating factors. United Mortgage claimed that the compensating factors were not on the mortgage credit analysis due to a system error because the loan was originated in another office".

United did not list the compensating factor on the 2900 worksheet due to the reason given to the auditor which was an inadvertent processing error. However there were numerous compensating factors that were weighed by the underwriter in granting mortgage approval. This mortgage was given to a "first time homebuyer" a single mother, a minority borrower purchasing a modest 2 bedroom 1 bath home who was working two job's to support herself and her two children. This loan could have easily have been approved in the sub-prime arena but in keeping with HUD's mission "of providing homeownership opportunities for the underserved segment of the marketplace" United felt that this borrower certainly met that criteria.

Additional consideration was given to the fact that the borrower had over 15 years with the Mount Vernon School District. The verification of employment documented that she had steadily received pay increases and as a member of the civil service employee union her raises were contractual in nature. The auditor felt that these contractual pay raises should not have been considered as the verification of employment **"did not indicate whether there would be any pay raises in the future"**. The three year earnings history per the verification of employment dated May 2004 confirmed the borrower received past salary increases of 3.6%; 4.0% and was scheduled for a increase in July 2004 however the amount of that increase was "not available" at the time of verification. The verification document itself does not ask for anything more then the date of the last and the date of the next raise. That raise information and the earning history over the last three years is what is required to establish the earning trend which is acceptable by HUD and every secondary market lender. The auditor's conclusion that contractual pay raises were not applicable in this case as there was no indication of "pay raises in the future" is an unjustified criticism of the underwriter's analysis of the mortgage loan.

HUD states that "each loan is a separate and unique transaction and that there may be other factors that demonstrate the borrower's ability and willingness to make timely mortgage payments". While HUD guidelines does not allow the lender to use gift funds to meet their definition of reserves deposits, underwriters in their evaluation of any loan consider "layering effects" both negative and positive. In this case the borrower had reserves in excess on four mortgage payments after closing which included \$1,756 available in her 401K and \$2,255 on deposit (after closing and the payoff of a collection account).

Another part of the positive "layering effect" considered by the underwriter was that the ex husband was responsible for the \$286.00 monthly Resort debt payment. United was able to obtain proof of one monthly payment as the ex husband would not cooperate in supplying the necessary 12 month history therefore the debt had to be included in the ratios.

Comment 8

Case Number: 374-4236831
Mortgage Amount: \$142,000.00
Settlement Date: June 18, 2003

A. The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD.

Due to an inadvertent error the underwriter did not list the compensating factor on the 2900 worksheet. Per our written correspondence with HUD's Quality Control Division as long as the compensating factors can be found in the credit file they may be relied on.

Although the ratios exceeded HUD benchmark guidelines the underwriter relied on the borrower having \$8,677.50 in cash reserves. Secondly the loan to value was 80% of the finished value.

Case Number: 371-3330273
Mortgage Amount: \$85,600.00
Settlement Date: December 12, 2003

A. The Borrower Did Not Re-Establish Good Credit After Bankruptcy

HUD Handbook 4155.1, REV 4, CHG 1, Paragraph 2-3 states that "A bankruptcy (Chapter 7 liquidation) will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged **and** the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs". Our borrowers had established and maintained a good credit history on four new accounts with a total outstanding balance of \$22,568.00. The borrowers had an exemplary credit history on these accounts and had successfully managed those debts over a two year period. The auditor stated that the borrowers "had been delinquent on a utility account and a revolving account subsequent to the bankruptcy" and that "United Mortgage did not provide an adequate explanation regarding the derogatory credit issue that occurred subsequent to the bankruptcy". These first time homebuyers provided a lengthy explanation regarding their credit circumstances detailing amongst other problems that he had been out on "workman's compensation for almost 2 years". Although not specifically addressed the credit line which had a zero balance and was "closed by the consumer" which under HUD's definition is a "minor" derogatory and a \$261.00 collection from a cable company which was explained in the overall circumstances of their credit situation.

B. All Conditions of the Commitment Were Not Met

The auditor quoted 4155.1, Rev 4, CHG-1, paragraph 3-12 "The lender is required to resolve all problems regarding title to the real estate, comply with all conditions of the commitment, close the loan before the expiration of the FHA-issued certificate of commitment or DE approval and expiration of the credit documents, and submit the loan documents for insurance within 60 days of loan closing".

The auditor stated that we "failed to comply with all conditions of the commitment" as we did not obtain 12 months cancelled rent checks. In lieu of the cancelled rental checks we accepted a "Verification of Rent" showing the borrower had an acceptable payment history. Either type of verification is acceptable according to HUD guidelines.

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Comment 30

Case Number: 351-4605626
Loan Amount: \$105,300.00
Settlement Date: May 13, 2004

Failure to Establish Income and Job Stability

Per the verification of employment in the file the borrower had been employed in his current position from 12/06/2002 through 4/12/2004. We have also obtained a verification of prior employment showing his employment history in the same line of work from 2/26/2001 through 11/5/2002. In addition we did have copies of two years tax returns and the 2003 W-2s in the file and the borrower's employment history was also stated on the credit report.

The co-borrowers prior verification of employment had an obvious date errors and was resent for confirmation. The employer affirmed that she had been employed from 11/25/2002 through 3/2004 for a total history of 18 months. Prior to that she we have obtained verification of her employ from 3/14/2002 through 8/11/2002. The "gap of employment as stated by the co-borrower was due to her pregnancy.

Appraisal Report was not Adequately Reviewed

As required by HUD Handbook 400.4 REV-1, Paragraph 3-3G the underwriter completed HUD form number 54113 showing the analysis of the appraisal and her concurrence with the value conclusions of the appraiser.

The auditor stated the "parents purchased the home in August 2003 for \$84,000. The sale over eight months later resulted on a 27 percent increase. However, the Uniform Residential Appraisal Report did not provide sufficient information to justify and substantiate a large increase in value". The auditor also stated that "the large increase in value provided the gift of equity funds of \$6,705.00" intimating the gift was the reason for the increase of the property value. Using that rationale a value of only \$90,705.00 would have been sufficient to allow for the gift.

The auditor's unsubstantiated comments and conclusions are without merit and the basis for his conclusion should have been stated in the findings. These findings seem to be based on the "gut feeling" of the auditor rather than his familiarity with this area. Can the auditor definitively state that an increase in value of 27%, with major improvements to the property, is not feasible? If so I would think in his critique of the appraisal he should have specifically defined for what additional information he felt was needed "to justify and substantiate a large increase in value".

Comment 21

Comment 27

The statement that the "mortgage lender may provide documentation showing the costs and extent of the rehabilitation that went into the property that resulted in the increase in value". Yes that would have been nice but HUD does not require any more documentation then what United submitted in the case file.

The appraiser stated in the body of the appraisal that "the home had been renovated within the last year" the appraisal was also provided a supplement showing that the following renovations had been made:

1. New kitchen cabinets, countertops, flooring, appliances.
2. New bathroom flooring, toilet, tub, wainscot.
3. All interior walls were painted.
4. New interior floor coverings.

The appraiser also noted that the subject property is located in an area where the residential market has shown a steady increase in market values over the last two years. This is due to a low inventory of available homes combined with low interest rates. This Market has been referred to as a "sellers market" by real estate professionals. In our meeting with the auditor in May where he expressed his concern with the value we ran an "Automated Valuation Module" of the subject property. The value of the AVM **is based solely on comparable sales and does not take the property improvements into consideration.** The value at that time was \$119,940.00 which shows an additional increase (with no improvements) of 11.7%.

Comment 7

Case Number: 251-3042694
Loan Amount: \$125,000.00
Settlement Date: January 27, 2004

A. The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD.

HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-12 states that "a ratio exceeding 29 percent may be acceptable if significant compensating factors are presented. Typically, for a borrower with limited recurring expense, greater latitude is permissible on this ratio than the total fixed payment ratio". The mortgage payment expense to effective income on this case was 37.0% however the underwriter exceeded the ratios based on the fact that the borrowers recurring expenses were only \$221.00 per month which was allowable under paragraph 2-12. The auditor disputed the underwriter's use of conservative credit as a compensating factor as his interpretation of the guidelines was that the "outstanding balance" of the credit be used. Per HUD guidelines state the "recurring expenses" be used rather than the unpaid balances.

The underwriter also included that she was "not using overtime or bonus income to qualify". Although the auditor felt that the use of this additional income had a "minimal effect on the borrowers ratios", HUD does not provide specific guideline or numbers regarding how much of an "impact" that additional income must have to qualify as a compensating factor. Also the underwriter is not limited to the factors listed in 4155.1 Rev-4 CHG 1. .

Case Number: 371-3372063
Loan Amount: \$86,250
Settlement Date: March 18, 2004

The Borrower Did Not Re-establish Good Credit After Bankruptcy

The findings in this case contradict the facts and in no way constitute violation of FHA requirements.

The auditor states "that the borrower did not re-establish good credit nor demonstrate an ability to manage his financial affairs" He further states that since the bankruptcy, which was discharged in August 2000, the borrower opened 11 new lines of credit. These 11 new lines of credit had a limit of \$35,279 and a balance of \$30,838.

The above is an inaccurate statement. The borrower actually opened 1 car loan since the bankruptcy and 10 lines of credit, with a balance of \$14,472. **NOT \$30,838 as previously stated by the OIG.** Out of the 11 new reestablished accounts, only one account went 30 days in February 2002. This was 2 years prior to the closing and was considered to be a very minor derogatory. At the time of approval, there were **29 first mortgage payments made without any lateness and 47 second mortgage payments made without any lateness.** The isolated "rolling" derogatory on the first mortgage was satisfactorily explained by the borrowers.

The following is a breakdown of the pay history for the re-established accounts after the bankruptcy .

- ❖ Long Beach Acceptance Auto Loan -18 perfect payments
- ❖ Cap 1 430572226268 – 19 perfect payments
- ❖ Providian – 26 perfect payments
- ❖ Cap 1 517805221057 – 18 perfect payments
- ❖ Cap 1 529115181864 -36 perfect payments
- ❖ Cap 1 529115205244 – 26 perfect payments
- ❖ Cap 1 4305982369068393 – 3 perfect payments
- ❖ Kay Jewelers – 12 perfect payments
- ❖ Cap 1 517805224877 – 15 perfect payments
- ❖ Target – 5 perfect payments
- ❖ Cap 1 529115180677 – 35 perfect payments with one 30 day in 2/02

We cannot fathom the auditor's "rationale" that the above payment pattern does not constitute good re-established credit. The auditor references HUD Handbook 4155.1 REV – 4 chg-1 Paragraph 2-3E, although the correct paragraph is 2-3F, a bankruptcy will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged and has demonstrated the ability to manage his financial affairs, both of which

occurred in this case. All HUD guidelines were adhered and the overall pattern of creditworthiness and pay histories on the reestablished accounts were reviewed. The guideline says borrower's must re-establish "good" credit, not "perfect" credit.

While HUD has established certain guidelines, credit analysis remains largely subjective. "Underwriting remains more art than science and requires that the underwriter carefully weigh the many aspects of the mortgage" Mortgagee letter 95-07

The following are the overall merits of the file and paint the "full picture" of this case:

- ❖ Ratios of 18/37
- ❖ Excellent employment tenure and union job (11 yrs for borrower/teamsters union and 3 yrs co-borrower)
- ❖ 15 year term
- ❖ Existing mortgages which were satisfied had rates of 7.875% and 9.50%. This loan closed at a rate of 6.00%
- ❖ Good re-established credit after bankruptcy
- ❖ 85% loan to value
- ❖ Minimal cash back to the borrower (\$2,300)
- ❖ Familiarity with homeownership and the costs associated with it. (the borrowers acquired their home in 1991)
- ❖ The borrowers elected not to include their mortgages in the bankruptcy, which evidenced good character and the willingness to pay
- ❖ Minimal increase in housing payment (\$29.16)
- ❖ Over 4 months reserves, although not on the application, properly documented on the borrower's pay stubs

The decision to grant this loan was well within HUD guidelines and was no way a contributing factor in the delinquency. The fact is that Mr. Bird suffered a severe back injury, and was unable work in his position as a bus driver. The borrower has since gone back to work. The borrower's have been diligently working with Chase to correct the matter and have since been approved for a loan modification due to financial hardship (see attached e-mail from Chase) We encourage the OIG or HUD to speak directly with the borrowers to fully ascertain the unforeseen circumstances that led to the delinquency.

Case Number: 371-3129664
Loan Amount: \$142,200
Settlement Date: February 28, 2003

A. The Borrower Did not Re-Establish Good Credit After Bankruptcy

The auditor stated that the borrower failed to “establish good credit after a bankruptcy”. Please see the credit report showing a ■■■ Bank car loan in the amount of \$13,470.00 opened after the bankruptcy. Furthermore the account reflected a perfect payment history.

The auditor states that “United Mortgage required on its conditions to the commitment that prior to closing the borrower must submit a satisfactory explanation regarding the derogatory credit listed on the credit report. The explanation didn’t address the mortgage account and the utility account”.

In our commitment dated July 17, 2002 our specific verbiage was as follows: “Prior to closing borrower to submit satisfactory explanation regarding the derogatory credit listed on the credit report”. The underwriter was requesting an explanation for the bankruptcy. As requested the letter of explanation was provided to us on November 19, 2002

This loan closed in February 2003, six years after the borrower filed for chapter 7 bankruptcy. Not only was this loan made in an underserved area but the borrower had 16 months in reserves after the closing, a loan to value of 83% and 7 years on the job. While we agree with the auditor that there were some late payments after the bankruptcy, these late payments occurred almost 5 years after the bankruptcy and were not judgments, charge offs or collection accounts which according to HUD’s rating of their seriousness they were considered “minor” in nature. In addition these accounts (per our commitment) had to be paid and satisfied at the time of closing.

Comment 26

Case Number: 091-3646170
Loan Amount: \$91,200.00
Settlement Date: October 29, 2002

A. United Mortgage Did Not Use all Debt when Calculating the Borrower's Total Monthly Debt Payments

The auditor stated that "United Mortgage did not include a \$300.00 monthly payment in the calculation of the monthly debt on the credit analysis worksheet. According to the borrower's credit report, this \$300.00 monthly payment was for an auto loan and should have been included in total monthly debt. This payment would have increased the borrower's total fixed payment to effective income ratio to 61.19%..."

The borrowers credit report dated October 04, 2002 shows the account in question, a car loan through [REDACTED] and had as of August 2002, 48 payments paid on the account.

The borrower's credit union bank statements reflect that the borrowers account was debited on 9/5 for a WFS "fee and payment" amount of \$320.00 and an ACH debit #109447 in the amount of \$310.00 paid 10/03. Therefore the loan payment did have to be included in the borrower's ratios.

Case Number: 291-3251765
 Loan Amount: 82,350.00
 Settlement Date: April 1, 2004

Failure to Establish Income and Job Stability

The auditors stated that United Mortgage Corp failed to verify the borrower's employment for the most two full years and that the borrower had only eight months of employment verified. In addition the auditors stated that **"there wasn't any documentation to support the time frame or the amount of income generated"**. Proof verifying a two year history for both borrowers was included in our case file and was also submitted to the auditors for their consideration. The borrower's employment history had been verified by a direct written verification of employment showing a current work history for a nine month period. Prior to the current position the borrower had been self employed since 2001 which was verified by the following documentation:

1. Copy of the Missouri Retail Sales License" dated 4/24/2001 showing that the borrower had been self employed as "Wooden Things".
2. Copy of two 2002 W-2 forms from the "Joplin Flea Market" where the borrower had sold the goods made from the business of "Wooden Things".
3. Letter from the borrower explaining that the business had failed and that the State of Missouri had placed a lien for non-payment of quarterly taxes.
4. Copy of letter of dismissal from the State of Missouri Director of Revenue vs. [REDACTED] stating that there was no longer a dispute between the two entities.

The co- borrower's employment history had been adequately verified for a two year period.

The auditor quotes that HUD Handbook 4155.1, Rev-5, paragraph 2-9 states that "income from self-employment is considered stable and effective if the borrower has been self employed for two or more years".

Self employment income was not included to calculate the borrower's effective monthly income therefore there was no need to **"support"** that income. The income ratios on this file were 20.4% and 37.6% based on the current income of both borrowers.

The auditor also raised the exception that "United failed to verify the borrower's employment for the most recent two full years". Per HUD Handbook 4155.1, Rev-5. Paragraph 2-6 HUD also states that they "do not impose a minimum length of time a borrower must have held a position to be eligible". Although the borrower had only 9 months on the current job he was able to prove in excess of a two year work history by proving proof of self employment.

Case Number 371-3386266
Name: Williams
Settlement Date: May 28, 2004

Note: The OIG has confused this case with case #351-4605626 on page 9 of the Draft

After careful and thorough consideration of all the facts and circumstances surrounding the audit findings of this loan, I am left to draw the only conclusion possible: the auditor is seeking indemnification of this loan, simply because the loan has gone into default, despite our due diligence in underwriting the file according to HUD's standards.

Appraisal Report Was Not Adequately Reviewed

The auditors stated that there was no evidence that United Mortgage questioned the appraised value of the subject property to determine whether or not the appraiser's conclusions were acceptable as required by HUD Handbook 4000.4 rev 1. The subject property sold for 52,500 on October 24, 2003. The appraised value was \$147,500. The auditor's state that this was a 181% increase in value over a six month period. The OIG further states that the appraisal report did not provide sufficient information to justify and substantiate a large increase in value.

As a result, the OIG recommends that United Mortgage reimburse HUD for claims and fees paid in the amount of \$154,921. The claim type filed is "02" under the ACD Demonstration. Since there has been no conveyance of the property, HUD has **not incurred a loss.**

The following are the facts as documented in the file:

The appraiser stated on page 1 that the property was in the process of being renovated and was in good condition. What the auditor's neglected to state is that the appraiser included five interior photos of the subject property, which clearly depicted the scope of the renovation. The appraiser further stated the following in his addendum: "In preparing for the appraisal assignment, the appraiser has performed the following analysis and actions necessary to obtain sufficient information in order to arrive at a supportable and defensible estimate of market value for the subject property. The subject property was visited and pictures were taken, **improvements were examined and measured and a thorough inspection of the site, improvements and location was analyzed.** Other considerations were given to the neighborhood, surrounding properties, schools, police and fire protection and other support facilities. The final estimate of value and conclusions enclosed in this report is based on available market data, the appraiser's knowledge, experience, training, and accepted appraisal methodology." Furthermore, the underwriter ordered a final inspection of the property, even though the second appraisal, as required by Mortgagee letter 2003-07, showed the satisfactory completion of the property.

Comment 5

The first appraisal, performed by Robert Buckles, was dated 03/27/2004. This appraisal was used for the basis of the underwriting decision since it was the more conservative of the two and also required a re-inspection of the property. A second appraisal was obtained in accordance with Mortgagee Letter 2003-07. This appraisal was dated 04/18/04 and performed by Brian Roeder. Although consideration was given to this report, it was not the "accepted" appraisal as incorrectly stated by the OIG. The auditor also incorrectly stated that comp one appraised at \$150,000 on April 18, 2004. This property did not appraise for \$150,000, it sold for \$150,000. The actual appraised value was \$148,450. Again, this second report was not the final basis for the decision, and was merely in accordance with Mortgagee letter 2003-07 to further support the value.

The auditor's stated that the deficiency of "inadequate review of the appraisal" should have precluded approval of this loan. Two separate HUD appraisers, the DE underwriter, a review appraiser and an AVM all concluded that the value was acceptable and supported. Handbook 4004.04 rev 1 Paragraph 3-3G states "upon completion of the review, if the underwriter has no comments or corrections to make to the appraisal, then HUD form 54113 will be sufficient evidence of the underwriter's review of the appraisal report" This form is contained in the file.

What the OIG neglected to state is the following:

- ❖ Ratios of 19.16/29.00
- ❖ Excellent job stability – 22 yrs for borrower and 6 yrs for co-borrower
- ❖ 19 months in cash reserves
- ❖ 2nd job was documented but not used to qualify (if 2nd job was used ratios would have been 17.07/25.83)
- ❖ First time homebuyers. Co-borrower is a minority.

United Mortgage strictly adhered to HUD's established protocol to insure the department's interest in the property. The documentation contained in our file clearly and concisely proves that United was in full compliance with HUD directives and exercised due diligence in the underwriting and origination of this loan.

Case Number: 374-4343748
Loan Amount: \$187,200
Settlement Date: February 18, 2003

A. The Lender Permitted a Cash-Out Refinance while the Borrower's Mortgage was Delinquent.

In his review the auditor stated that "HUD permits streamline refinancing of mortgages that are no more than two months delinquent at the time of refinance, we also recognize there are situations where borrowers more than two months behind in their payments could cure their delinquency if they could refinance the mortgage and also retire any arrearage on the mortgage". This is precisely what we accomplished for the borrowers by approving the refinance mortgage thus taking the borrowers out of their 203k mortgage loan with a rate of 8.00% and refinancing the loan at a rate of 6.50%. Our goal was to cure any delinquency, reduce the monthly payments and give the borrowers some "cash back" as a financial cushion. The auditor quotes Mortgagee Letter 94-30 where there can be no cash back on a "streamline refinance" which is satisfying a delinquent mortgage loan. This transaction was not a streamline refinance mortgage and the criterion in the mortgagee letter is not applicable. In addition per HUD Handbook 4155. Rev 4 1-11 B our handling of this transaction was not prohibited.

The auditor stated that their "was no evidence in the file indicating the United Mortgage considered the delinquency when originating the new loan". We had been the originating lender on the 203k loan and were most certainly aware that the borrower had been late several times on their mortgage payments – one would only have to review the credit report as the auditor did to "discover" that the mortgage had been late.

The auditor also stated that "the borrower was delinquent on his mortgage payment at the time the mortgage credit analysis was prepared" which was December 10, 2003. The credit report dated 11/21/2003 shows the loan was due for October 1, 2003. Per HUD Handbook 4155 Rev 4 3-1 "credit documents may be up to 120 days at the time the loan closes" there is no obligation for a lender to re-underwrite the file as long as the credit documents have not expired. Also HUD's definition of the Date of Default (24 CFR 203.466) is as follows "The date of default shall be considered 30 days after:

1. the first uncorrected failure to perform, any obligation under the mortgage; or
2. the first failure to make a monthly payment which subsequent payments by the mortgagor are insufficient to cover when applied to overdue monthly payment in the order in which they become due.

EXAMPLE: February 1 - last paid installment
March 1 - date first failure to perform.
April 1 - date of default.

Comment 31

Even if one used the payoff letter dated 12/22/2003 which showed the October 1 payment due using HUD's definition of "default" this would make the account no more than 60 days late at that time.

Example:

September 1 – last payment made

October 1 – date first failure to perform

November 1- date of default.

December 1 – 60 days late.

The auditor also stated that "According to Neighborhood Watch Early Warning System, the loan that the borrower was refinancing was delinquent on January 1, 2004. The system indicated that the borrower's November 1, 2003 installment was their oldest unpaid installment". Again the loan was not delinquent in excess of 60 days.

Example:

October 1 – last payment made.

November 1- date first failure to perform.

December 1- date of default.

January 1 – 60 days late.

I would like to also add that even with the additional cash out there was a \$158.00 per month reduction of the principal and interest payments.

Appendix B

AUDITEE COMMENTS AND OIG'S EVALUATION

- Comment 1** The conclusions made in our report are based on the information contained in the loan case files at the time of our review. As such, our conclusions address deficiencies and weaknesses in United Mortgage's underwriting practices as measured against HUD requirements.
- Comment 2** Our report recommends reimbursement and indemnification for the cases we believe the significance of the underwriting deficiencies adversely affected the risk assumed by the FHA Insurance fund. As such, our decisions are reasonable considering the level of the underwriting and are based upon criteria in HUD regulations and additional guidance promulgated by HUD.
- Comment 3** Our report cites the default rate for loans originated during our audit period, November 01, 2002 through October 31, 2004, in order to provide one of the reasons United Mortgage was selected for audit. Any inaccuracies in the Neighborhood Watch system would not have precluded us from conducting a review, as we know this rate will fluctuate over time based on the number of loans originated and the default history.
- Comment 4** The scope of the review is based on a number of factors. In this audit, 33 loans were selected for full origination review and 16 loans were selected for a limited review of compensating factors used to support cases with high back ratios.
- Comment 5** The appraisals did not justify the value of the property at the time of the appraisal. Thus, the underwriter did not have adequate information to determine whether the appraisers' conclusions were acceptable. Yes the appraisal had pictures, but there was no narrative to explain what repairs were actually performed.
- Comment 6** These loans were only reviewed for adequate compensating factors and not examined for other origination deficiencies, further OIG acknowledges that there may be more substantial compensating factors than those listed in HUD Handbook 4155. 1 Paragraph 2-13. However, OIG's findings are based on the compensating factors that were listed on the Mortgage Credit Analysis Worksheet and any additional compensating factors provided by United Mortgage for those cases where compensating factors were not listed.
- Comment 7** We were not provided evidence that United Mortgage demonstrated that the borrower had a conservative attitude toward credit and an ability to accumulate savings. Also, United Mortgage did not provide evidence that there was potential for increased earnings as indicated by job training or education in the borrower's profession. Further, the documentation provided in the files did not indicate the continuance of overtime and bonus income.
- Comment 8** At the time of the audit, United Mortgage did not mention that a compensating factor was that the borrower had substantial cash reserves after the closing in excess of six months

principal, interest, taxes and insurance. Furthermore, based on the information on the Mortgage Credit Analysis Worksheet, the HUD-1, and based on the grant that the borrower received, OIG does not agree that there was six months of cash reserves.

- Comment 9** During the audit, United Mortgage provided two compensating factors. They were substantial cash reserves in excess of three months and potential increased earnings as evidenced by contractual pay increases. There were no excess reserves as stated because the nature of the assets was gift funds, which cannot be considered as reserves. United Mortgage also did not take into account a collection account that was supposed to be paid prior to closing. Furthermore, although there were pay increases in the past, the verification of employment did not indicate whether there would be any pay increases in the future.
- Comment 10** The compensating factors of contractual pay increases and good earnings potential were not supported. Further, the credit report did not support the compensating factor of conservative use of credit.
- Comment 11** Mortgagee Letter 00-28 provides that funds from gifts from any source are not to be included as cash reserves. United Mortgage did not demonstrate that the borrower had the ability to accumulate savings nor that the borrower had a conservative attitude toward credit.
- Comment 12** HUD Handbook 4155.1 REV-5, Paragraph 2-13 G provides that funds borrowed from retirement funds may be used for loan closings, but are not to be considered as cash reserves. The borrower's employment is a condition of approving the loan.
- Comment 13** United Mortgage did not address the compensating factors provided on the Mortgage Credit Analysis Worksheet. United Mortgage explained that during the audit a compensating factor was the decrease in housing expense. However, the monthly payment was inaccurate. Actually, the mortgage payment increased from \$731 per month to \$868 per month. United Mortgage included \$321 per month on a trailer as being refinanced and did not include it after the refinance. Further, there was no evidence on the HUD-1 that this loan was paid off.
- Comment 14** Conservative use of credit is not in itself an adequate compensating factor. The borrower would have had to demonstrate an ability to accumulate savings and have a conservative attitude toward the use of credit as requirement by HUD Handbook 4155.1, Paragraph 2-13.
- Comment 15** The six open lines of credit and sixteen other accounts that are either closed or have no current balances did not represent a conservative attitude toward the use of credit. In addition, the borrower's bank accounts demonstrated that the borrower did not have the ability to accumulate savings as the borrower relied on four large deposits to meet the asset requirements. Further, the cash reserves verified on the Mortgage Credit Analysis Worksheet amounted to \$582.34. We also did not consider the minimal increase in the borrower's housing expense and the lack of late payments on the previous mortgage payment history as an adequate compensating factor. These items were not identified on the Mortgage Credit Analysis Worksheet and they were discussed with United Mortgage during the audit.
- Comment 16** There were discrepancies in the amount of overtime, and bonus income that was included in the effective income. We determined that the overtime that was not included would have had

a minimal impact on the ratios. Although we did not examine the borrowers' job history extensively, there appeared to be questions about the borrowers' meeting the job stability requirements. We believe this should be examined because United Mortgage is claiming additional income that was not used to qualify the loan.

- Comment 17** The borrower's credit explanation seemed to justify their need to file bankruptcy and did not address the delinquencies to a utility account and a revolving account subsequent to the bankruptcy discharge.
- Comment 18** The borrower did not re-establish good credit or demonstrate an ability to manage his financial affairs as evidenced by the late payments on his prior mortgage, utility account and a revolving loan. Following the bankruptcy, the borrower opened 11 new accounts. One of these new accounts was a car loan. Including or excluding the car loan, the borrower's credit balance was near the allowable limit. This does not demonstrate an ability to manage his affairs and re-establish good credit.
- Comment 19** United Mortgage required as one of its conditions to the commitment that prior to closing the borrower must submit a satisfactory explanation regarding the derogatory credit listed on the credit report. The explanation didn't address the mortgage account and the utility account.
- Comment 20** United Mortgage continues to include amounts in their calculation of regular pay that has been included in overtime. United Mortgage makes the assumption that regular pay is based on 40 hours a week. There is no indication of that in the verification of employment and the payment stubs. We concur that United Mortgage could use the increase pay of \$24.10 to indicate the borrower's earning potential for 2004. Again, United Mortgage would have needed to determine how many hours per week are regular hours versus overtime. Also, there wasn't any evidence provided for the \$25.84 amount for the underwriter to make an income determination.
- Comment 21** The fact remains that at the time of underwriter approval, United Mortgage did not have adequate documentation to support income stability. We have not reviewed any of the additional documents United Mortgage obtained subsequent to our audit, which were not included in the case files.
- Comment 22** United Mortgage has not provided adequate documentation to support income and job stability of the borrower for the most recent two years. We were only able to verify 8 months of the borrowers employment. Further, although self-employment income was not used per United's comments, the borrower did not prove self-employment. The fact that the borrower had a sales license is not sufficient; United Mortgage should have requested the borrowers tax return to verify self-employment.
- Comment 23** United Mortgage did not obtain the necessary documentation to ensure that the judgments had been paid in full contrary to its own policies. Further, evidence that the title insurance cleared these judgments was not presented to us during the audit. Moreover, the OIG auditor did not instruct United Mortgage officials not to contact the borrowers.

- Comment 24** United Mortgage failed to properly verify facsimile documentation related to the student loan. The files contain a letter stating that the loan was due six months after graduation, which was supposed to be two months after the closing. As such, United Mortgage officials should have done more by requesting the student transcript and including this loan in the ratio computations. In addition, the OIG auditors did not request that documents be backdated.
- Comment 25** United Mortgage concurred that a credit explanation could not be located in the files. A credit explanation letter may have identified that the borrower was obtaining additional debt. Further, the number of inquiries on the borrower's credit report and no explanation letter is evidence that United Mortgage should have taken some action; as such, our concerns are not without merit.
- Comment 26** United Mortgage concurred that the debt should have been included in the borrower's ratios.
- Comment 27** The appraisal reports did not justify the value of the property at the time of the appraisal. Thus, there is no assurance that the underwriter had adequate information to determine whether the appraisers' conclusions were acceptable. There were neither pictures of the renovation work nor a supplemental listing of the repairs in the files at the time of our review.
- Comment 28** United Mortgage used the co-borrowers income in the calculation of the borrowers ratios, however, they did not use the co-borrower's debt or revolving credit. Without considering the co-borrower's entire expenses in the calculation of the borrower's ratios, we have no assurance that the ratios met HUD requirements. HUD requires lenders to carefully ascertain and report all assets and liabilities of prospective borrowers and co-borrowers.
- Comment 29** United Mortgage's argument that the borrower has long term debt, a student loan, that will not extend beyond the term of the buy-down agreement appears to have some merit. However, United Mortgage did not discuss this interpretation of the criteria during the course of the audit nor in specific discussions regarding this loan. Additionally, United Mortgage did not document their interpretation or explain their position in the file.
- Comment 30** United failed to comply with all conditions of the commitment. The rental verification letter from the landlord indicated that the rent is paid up to date. However, the letter did not provide the borrower's payment history. The basic hierarchy of credit evaluation is the manner of payments made on previous housing expenses, including utilities, followed by the payment history of installment debts then revolving accounts. The payment history of the borrower's housing obligations is of significant importance in evaluating credit. The lender must determine the borrower's payment history of the housing obligations through the credit report, directly from the landlord or mortgage servicer, or through canceled checks covering the most recent 12-month period.
- Comment 31** Mortgagee letter (ML) 94-30 that relates to all refinancing of delinquent mortgages is clear. Although arrears and closing costs may be paid through funds generated from refinancing a delinquent loan, there can be no cash back to borrowers in these transactions.

Appendix C

Summary of Loan Origination Deficiencies

Case Number	Mortgage Amount	Amount Requested for Indemnification	Inadequate or Incomplete Compensating Factors	Borrower Did Not Re-establish Good Credit Following Bankruptcy	Inadequate Income Verification	Questionable Documents Provided	Inadequate Debt Verification	Inadequate Appraisal Review	Other Origination Deficiencies	Appendix Reference
374-4347581	\$275,650	\$275,650	X		X	X				D-01
061-2722023	\$164,900	\$164,900				X	X		X	D-02
371-3362145	\$118,300	\$118,300	X						X	D-03
374-4236831	\$142,000	\$142,000	X							D-04
371-3330273	\$85,600	\$85,600		X					X	D-05
351-4605626	\$105,300	\$105,300			X			X		D-06
251-3042694	\$125,000	\$125,000	X							D-07
371-3372063	\$86,250	\$86,250		X						D-08
371-3129664	\$142,200	\$142,200		X						D-09
091-3646170	\$91,200	\$91,200					X			D-10
291-3251765	\$82,350	\$82,350			X					D-11
371-3386266	\$145,350							X		D-12
374-4343748	\$187,200	\$187,200							X	D-13
Subtotal	\$1,751,300	\$1,605,950	4	3	3	2	2	2	4	
371-3355512	\$114,900	\$114,900	X							E-01
351-4593484	\$137,700	\$137,700	X							E-02
292-4475818	\$81,700	\$81,700	X							E-03
371-3356599	\$85,950	\$85,950	X							E-04
374-4415719	\$399,700	\$399,700	X							E-05
371-3401203	\$82,650	\$82,650	X							E-06
052-3495166	\$157,500	\$157,500	X							E-07
Subtotal	\$1,060,100	\$1,060,100	7							
Total	\$2,811,400	\$2,666,050	11							

Appendix D

Narrative Case File Presentation

Appendix D-01

Case Number: 374-4347581
Loan Amount: \$275,650
Settlement Date: January 30, 2004
Status: Current

A. Questionable Documentation

The file contained questionable judgment verifications. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-3 C requires that judgments must be paid off before the mortgage loan is eligible for endorsement. As such, United Mortgage required the borrower to provide adequate documentation to evidence that judgments totaling \$4,876 had been paid in full. The file included two letters explaining that judgments had been satisfied. Each of these letters was provided to United Mortgage via facsimile with incomplete header information. There is no indication that anyone re-verified the information as we were told United Mortgage's processors do when documents are provided by facsimile. United Mortgage's president felt that based on the responses on the letters, the judgments of \$4,876 were not significant to require additional follow-up. We spoke to the parties who supposedly signed the documents. They claimed that they were not party to the judgments and did not know the borrower or anything regarding the judgment. In addition, the borrower was to provide the source of the payment. The file did not contain any source of the payment.

B. Inadequate Income Verification and the Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

United Mortgage indicated that the borrower's gross monthly income was \$6,096.70. We calculated it to be \$5,679.55. The change increased the total fixed payment to effective income ratio to 47.07 percent. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-12 states that this ratio cannot exceed 41 percent without listing significant compensating factors. United Mortgage determined the base pay to be \$4,056.00 from the income verification. We calculated the income to be \$3,604.83. The compensating factors listed on the mortgage credit analysis worksheet included contractual pay increases, good earnings potential and conservative use of credit. The compensating factors of contractual pay increases and good earnings potential were not supported. The verification of employment did not indicate that there were contractual pay increases or that the borrower had the potential for increased earnings as indicated by job training or education in the borrower's profession. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-13 states that the potential for increased earnings can be used as a significant compensating factor if it is indicated by job training or education in the borrower's profession. In regards to conservative use of credit, the credit reports did not support this compensating factor.

Case Number: 061-2722023
Loan Amount: \$164,900
Settlement Date: January 9, 2004
Status: Default, Modification

A. Questionable Documentation

The file contained questionable debt verification. The documents provided indicated that student loans were due for repayment in over a year. Thus, it was not considered in the underwriting analysis. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-11 C requires that if a debt payment, such as a student loan, is scheduled to begin within twelve months of the mortgage loan closing, the lender must include the anticipated monthly obligation in the underwriting analysis. The student loan provider indicated that the loans became due shortly after closing. Thus, the debt should have been included as part of the analysis of the borrowers liabilities. United Mortgage failed to properly verify documentation that would have led to questioning the reliability of the debt verification documentation. For example, United Mortgage required as part of the conditions of the commitment that the borrower provide her college transcripts. There were no college transcripts in the file. United Mortgage explained that the underwriter waived this condition due to the fact that there was a letter from the university attesting that she had been a student through 2003. In regards to this letter, United Mortgage failed to question and verify it. We inquired with the Registrar's office and learned that the borrower last attended the college in 2002. Also, United Mortgage failed to follow its procedures regarding facsimile documents. Both the loan provider and the Registrar's office letters were faxed to United Mortgage. According to United Mortgage, they verify all facsimile documentation supporting the processing or conditions of the loan. The impact of this debt to the borrower's ratios would have required significant compensating factors to approve the loan.

B. United Mortgage Processed Loan As If the Co-borrower Was Going To Be an Owner-occupant

It was disclosed by the borrower that the co-borrower had no intention of occupying the property as their primary residence and was only assisting her in buying the home. The borrower stated that United Mortgage's loan officer was made aware of this fact. By failing to consider the co-borrower to be a non-occupant co-borrower, consideration was not given to ascertaining and verifying the co-borrowers liabilities arising from not living at the purchased property (i.e., rent, mortgage payments, utilities, etc.). Absent such knowledge, we could not calculate the correct qualifying ratios. HUD requires lenders to carefully ascertain and report all assets and liabilities of prospective borrowers and co-borrowers.

C. Failure to Adequately Analyze the Borrower's Credit

The borrower had over 85 inquiries on her credit report. In fact, 20 of those inquiries were in the month prior to when the credit report was examined. However, United Mortgage did not require the borrower to explain the inquiries that were on the report. These credit items are significant due to the fact that the quality control review performed on this loan found that significant liabilities were incurred between the application date and the closing, which were not included in the ratios. Specifically, a \$22,936 Credit Acceptance account dated December 2003 was not shown on the initial credit report. The additional \$478 monthly liability would have increased the debt ratio from 38.01 percent to 47.96 percent. The ratio increase does not include the affects of the student loan above.

Furthermore, the co-borrower had derogatory debt items on his credit report. The co-borrower's explanation did not adequately explain his derogatory credit. Also, the co-borrower's credit report indicated eight student loans that were all open a couple of months prior to the credit report being examined. United Mortgage should have requested proof that the student loans were deferred for twelve months.

Case Number: 371-3362145
Loan Amount: \$118,300
Settlement Date: May 28, 2004
Status: Default

A. United Mortgage Did Not Establish That the Eventual Increase in Mortgage Payments Would Not Affect the Borrower Adversely

The borrower paid for a temporary interest rate buydown, and United Mortgage underwrote the loan at two percent below the actual note rate. However, United Mortgage did not provide evidence on whether the eventual increase in mortgage payments (when the loan reverts to the actual note rate) would affect the borrower's ability to make the mortgage payments. As such, according to HUD Handbook 4155.1 REV-5, Paragraph 2-14, United Mortgage had to document that the borrower met one of the following criteria. The borrower must have had a potential income increase that would offset the scheduled payment increases. Further, the borrower must demonstrate the ability to manage financial obligations in such a way that a greater portion of income may be devoted to housing expenses. Likewise, United Mortgage should have shown that the borrower had substantial assets available to cushion the effect of the increased payments or that the cash investment made by the borrower substantially exceeded the minimum required. United Mortgage did not provide any support that the borrower met this criteria. In addition, the borrower's income and debt history does not support any of the criteria.

B. The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment to effective income ratio was 44.96 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that the ratio cannot exceed 41 percent without listing significant compensating factors. The mortgage credit analysis worksheet did not list any compensating factors. United Mortgage claimed that the compensating factors were not on the mortgage credit analysis worksheet due to a system error because the loan was originated in another branch office. United Mortgage stated that the compensating factors were substantial cash reserves in excess of three months and potential increased earnings as evidenced by contractual pay increases. The gift funds provided gave the borrower their cash reserves. However, HUD Handbook 4155.1 REV-5, Paragraph 2-13 G provides that funds from gifts from any source are not to be included in cash reserves. Likewise, the reserves are questionable because United Mortgage should have reduced the available assets by the amount of a collection account that was supposed to be paid shortly before closing. In regards to contractual pay increases, the verification of employment did not indicate whether there would be any pay increase in the future.

Case Number: 374-4236831
Loan Amount: \$142,000
Settlement Date: June 18, 2003
Status: Current

A. The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's mortgage payment expense to effective income ratio was 38.39 percent and the borrower's total fixed payment to effective income ratio was 45.09 percent. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-12 states that these ratios cannot exceed 29 and 41 percent respectively without listing significant compensating factors. There were no compensating factors on the mortgage credit analysis worksheet. United Mortgage also believes the borrower had excellent earnings potential, as the borrower was a recent college graduate. The use of this compensating factor was not adequately supported in the file. The borrower being a recent college graduate by itself does not constitute an adequate compensating factor. Also the files did not support the excess earning potential.

Case Number: 371-3330273
Loan Amount: \$85,600
Settlement Date: December 12, 2003
Status: Default

A. The Borrower Did Not Re-Established Good Credit After Bankruptcy

The borrower had collection accounts and had been delinquent on a utility account and a revolving account subsequent to a bankruptcy discharge. HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3 states that a bankruptcy will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged and the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs. United Mortgage did not provide an adequate explanation regarding the derogatory credit issues that occurred subsequent to the bankruptcy.

B. All Conditions of the Commitment Were Not Met

United Mortgage failed to comply with all conditions of the commitment. HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 3-12 states that the lender is required to resolve all problems regarding title to the real estate and comply with all conditions of the commitment within 60 days of loan closing. United Mortgage required, on its conditions to the commitment, that prior to closing the borrower provide copies of twelve months of cancelled checks evidencing satisfactory rental payment history. There was insufficient evidence in the file to conclude that the items were obtained.

Case Number: 351-4605626
Loan Amount: \$105,300
Settlement Date: May 13, 2004
Status: Current

A. Failure to Establish Income and Job Stability

United Mortgage failed to verify the borrower's employment for the most recent two full years. The borrower indicated that he worked in his current position for a year and a half at the time of application. HUD Handbook 4155.1, REV-5, Paragraph 2-6 states that the lender must verify the borrower's employment for the most recent two full years. There was no indication of previous employment in the file. Further, the co-borrower had only a month experience in her current position and previous employment of one year at the time of application. However, United Mortgage did not verify two years of employment as required.

B. Appraisal Report was Not Adequately Reviewed

There was no evidence provided to show that United Mortgage questioned the appraised value of the subject property to determine whether the appraiser's conclusions were acceptable as required by HUD Handbook 4000.4 REV-1, Paragraph 3-3 G. The borrowers' parents purchased the home in August 2003 for \$84,000. The sale over eight months later resulted in a 27 percent increase. However, the Uniform Residential Appraisal Report did not provide sufficient information to justify and substantiate a large increase in value. The large increase in value provided the gift of equity funds of \$6,705 that was used by the borrower to meet their minimum required investment.

Case Number: 251-3042694
Loan Amount: \$125,000
Settlement Date: January 27, 2004
Status: Current, Partial claim paid, Loss mitigation retention, \$10,827 paid on May 17, 2005

A. The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's mortgage payment expense to effective income ratio was 37.04 percent and the borrower's total fixed payment to effective income ratio was 45.25 percent. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-12 states that these ratios cannot exceed 29 percent and 41 percent respectively without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet (conservative use of credit, good earnings potential, and overtime and bonus income not used to qualify for the loan). Regarding the conservative use of credit and the ability to accumulate savings, the borrower only had \$1,919 available at the time the mortgage credit analysis worksheet was prepared. While the borrower only had two credit lines open, one was opened 3 months prior to closing and close to its maximum allowable limit. The credit limit was \$2,500 and the borrower was carrying a \$2,043 balance.

In regards to good earnings potential, United Mortgage did not provide evidence that there was a potential for increased earnings as indicated by job training or education in the borrower's profession.

Regarding the overtime and bonus income not used to qualify, the verification of employment did not state whether the income was likely to continue. Also, there was no overtime or bonus income earnings trend established on the verification of employment or elsewhere in the file. The borrower earned \$673 in bonus income in 2003, but none in 2002. The borrower earned \$230 in overtime income in 2002, but none in 2003. These combined earnings had a minimal effect on the borrower's ratios.

Case Number: 371-3372063
Loan Amount: \$86,250
Settlement Date: March 18, 2004
Status: Default

A. The Borrower Did Not Re-Establish Good Credit After Bankruptcy.

The borrower filed for Chapter 7 bankruptcy on April 17, 2000 and it was discharged on August 23, 2000. The loan closed on March 18, 2004. According to HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3E, a bankruptcy will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged and the borrower has re-established good credit (or has chosen not to incur new credit obligations), and has demonstrated an ability to manage financial affairs. The borrower's credit report indicated that the borrower had chosen to incur new credit obligations since the discharge date of the bankruptcy. Further, the borrower did not re-establish good credit nor demonstrate an ability to manage his financial affairs. Since the bankruptcy discharge date, the borrower opened 11 new lines of credit. These 11 new credit lines had a limit of \$35,279 and a balance of \$30,838. Additionally, one of these new lines of credit had a late payment in excess of 30 days. The borrower's prior mortgage had four instances of late payments greater than 30 days, one instance of late payments greater than 60 days, and five instances of late payments greater than 90 days. There were missed payments in April, May and June 2001. Also, the borrower had late payments on a utility account. The borrower had missed payments on this utility account in March, July, August, and October 2003.

Case Number: 371-3129664
Loan Amount: \$142,200
Settlement Date: February 28, 2003
Status: Current

A. The Borrower Did Not Re-Established Good Credit After Bankruptcy

The borrower failed to establish good credit subsequent to a bankruptcy. According to HUD Handbook 4155.1, REV-4, CHG-1, Paragraph 2-3E, a bankruptcy will not disqualify the borrower if at least two years have passed since the bankruptcy was discharged and the borrower has re-established good credit, and has demonstrated an ability to manage financial affairs. However, the borrower had been delinquent on a previous mortgage, a utility account and a revolving account subsequent to the bankruptcy discharge. United Mortgage failed to adequately scrutinize the borrower's recent past credit history as provided in the commitment. United Mortgage required on its conditions to the commitment that prior to closing the borrower must submit a satisfactory explanation regarding the derogatory credit listed on the credit report. The explanation didn't address the mortgage account and the utility account.

Case Number: 091-3646170
Loan Amount: \$91,200
Settlement Date: October 29, 2002
Status: Current

A. United Mortgage Did Not Use all Debt when Calculating the Borrower's Total Monthly Debt Payments

United Mortgage did not include a \$300 monthly payment in the calculation of monthly debt on the mortgage credit analysis worksheet. According to the borrower's credit report, this \$300 monthly payment was for an auto loan and should have been included in total monthly debt. This payment would have increased the borrower's total fixed payment to effective income ratio to 61.19 percent. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph. 2-12 states that the borrower's liabilities include all installment loans, revolving charge accounts, real estate loans, alimony, child support, and all other continuing obligations. In computing the debt-to-income ratios, the lender must include the monthly housing expense, and all other additional recurring charges including payments on installment accounts, child support or separate maintenance payments, revolving accounts and alimony, etc., extending ten months or more. United Mortgage explained that they thought this debt had less than ten payments remaining; and therefore, should not be included in the calculation of monthly debt. However, they did not provide evidence that there were less than 10 payments remaining.

Case Number: 291-3251765
Loan Amount: \$82,350
Settlement Date: April 1, 2004
Status: Default

A. Failure to Establish Income and Job Stability

United Mortgage failed to verify the borrower's employment for the most recent two full years. The borrower had only eight months of employment verified. HUD Handbook 4155.1, REV-5, Paragraph 2-6 states that the lender must verify the borrower's employment for the most recent two full years. Prior to that, he was listed as self employed in construction for a year on the loan application. However, there wasn't any documentation to support the time frame or the amount of income generated. HUD Handbook 4155.1, REV-5, Paragraph 2-9 states that income from self-employment is considered stable and effective if the borrower has been self-employed for two or more years.

Case Number: 371-3386266
Loan Amount: \$145,350
Settlement Date: May 28, 2004
Status: Claim, \$154,921.31 was paid on May 12, 2005

A. Appraisal Report Was Not Adequately Reviewed

There was no evidence provided that United Mortgage questioned the appraised value of the subject property to determine whether or not the appraiser's conclusions were acceptable as required by HUD Handbook 4000.4 REV-1, Paragraph 3-3 G. The subject property sold for \$52,500 on October 24, 2003. The appraised value was \$147,500 on April 18, 2004. This was a 181 percent increase in value over a 6 month period. However, the Uniform Residential Appraisal Report did not provide sufficient information to justify and substantiate a large increase in value. The time period between prior sales date and the date of the sales contract was 4 months. Mortgagee Letter 03-07 states that, "If the re-sale date is between 91 and 180 days following acquisition by the seller, the lender is required to obtain a second appraisal made by another appraiser if the resale price is 100 percent or more over the price paid by the seller when the property was acquired. The mortgage lender may also provide documentation showing the costs and extent of rehabilitation that went into the property resulting in the increased value but must still obtain the second appraisal." Although there was a second appraisal in the file, this appraisal was done prior to the accepted appraisal and did not support the increase in sales price. The prior appraisal was rejected because United Mortgage thought it was inaccurate.

Also, there was no evidence that United Mortgage questioned the appraised value of comparable one on the Uniform Residential Appraisal Report to determine whether or not the appraiser's conclusions were acceptable. Comparable one sold for \$60,000 on January 17, 2003. The appraised value was \$150,000 on April 18, 2004. This was a 150 percent increase in value over a 15 month period. However, the Uniform Residential Appraisal Report did not provide sufficient information to justify and substantiate a large increase in value.

Case Number: 374-4343748
Loan Amount: \$187,200
Settlement Date: February 18, 2004
Status: Current

A. The Lender Permitted a Cash-Out Refinance while the Borrower's Mortgage was Delinquent

The loan that the borrower was refinancing (374-3982148) was delinquent at the time of loan application. The payoff statement indicated past mortgage interest payments totaling \$5,201.60. These were from unpaid mortgage payments from October, November, and December 2003. The payoff statement further showed late charges due totaling \$319.30. These charges were for five delinquent or unpaid mortgage payments in the amount of \$63.86 per delinquency.

According to Neighborhood Watch Early Warning System, the loan that the borrower was refinancing was delinquent on January 1, 2004. The system indicated that the borrower's November 1, 2003 installment was their oldest unpaid installment. The borrower's credit report indicated five instances of delinquencies of 30 days on the borrower's real estate debt. There was no evidence in the file indicating that United Mortgage considered the delinquency when originating the new loan. The mortgage credit analysis worksheet was dated December 10, 2003. The borrower was delinquent on his mortgage at the time the mortgage credit analysis worksheet was prepared. Although HUD permits streamline refinancing of mortgages that are no more than two months delinquent at the time of refinance, we also recognize there are situations where borrowers more than two months behind in their payments could cure their delinquency if they could refinance the mortgage and also retire any arrearage on the mortgage. However, according to Mortgagee Letter 94-30, there can be no cash back to the borrower in these transactions. The borrower received cash back of \$12,667.

Appendix E

Case File Presentation for Loans with Inadequate Compensating Factors

Appendix E-01

Case Number: 371-3355512
Loan Amount: \$114,900
Settlement Date: February 13, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's mortgage payment expense to effective income ratio was 33.13 percent and the borrower's total fixed payment to effective income ratio was 48.19 percent. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-12 states that these ratios cannot exceed 29 and 41 percent respectively without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet (good earnings potential, conservative use of credit, and good cash reserves). Regarding good earnings potential, we found no evidence in the file that indicated that the borrower had the potential for increased earnings as evidenced by job training or education in the borrower's profession.

Regarding the conservative use of credit, the borrower had eight open lines of credit. The borrower's credit report indicated an outstanding debt balance of \$17,328 with a limit of \$26,740 on all open accounts. HUD Handbook 4155.1 REV-4, CHG-1, Paragraph 2-13 prescribes that the borrower must demonstrate an ability to accumulate savings and a conservative attitude toward the use of credit. United Mortgage did not provide evidence that the borrower had the ability to accumulate savings. In addition, the borrower had not demonstrated a conservative attitude toward credit.

Regarding good cash reserves, United Mortgage stated that the borrower had over three months in reserves. The borrower received a gift of \$9,000 prior to closing. Without receiving this gift, the borrower had no cash reserves. Mortgagee Letter 00-28 provides that funds from gifts from any source are not to be included as cash reserves.

Case Number: 351-4593484
Loan Amount: \$137,700
Settlement Date: June 28, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment to effective income ratio was 46.84 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that this ratio cannot exceed 41 percent without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet. Regarding good cash reserves, the mortgage credit analysis worksheet indicated cash reserves of \$0. United Mortgage stated that the borrower had a 401k plan that was not counted as reserves. However, HUD Handbook 4155.1 REV-5, Paragraph 2-13 G provides that funds borrowed from retirement funds may be used for loan closings, but are not to be considered as cash reserves.

The compensating factor, "Not using overtime income to qualify", was not a valid compensating factor because United Mortgage used the borrower's overtime income in the base pay amount on the mortgage credit analysis worksheet. The borrower's overtime income was included in the gross monthly income used to calculate the ratios.

Contractual pay increases was not supported as a valid compensating factor. The borrower's verification of employment indicated the date of the borrower's next pay increase to be in January 2005. However, there was no exact date or amount of the pay increase listed on the form.

Case Number: 292-4475818
Loan Amount: \$81,700
Settlement Date: March 02, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's mortgage payment expense to effective income ratio was 31.87 percent and the borrower's total fixed payment to effective income ratio was 46.26 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that these ratios cannot exceed 29 and 41 percent respectively without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet. United Mortgage explained that the borrower had three months of cash reserves. However, the borrower had \$830.81 of cash reserves documented and a monthly principal, interest, taxes and insurance payment of \$718.03. Next, United Mortgage provided as a compensating factor conservative use of credit. Conservative use of credit is not in itself an adequate compensating factor. The borrower would have had to demonstrate an ability to accumulate saving and have a conservative attitude toward the use of credit as required by HUD Handbook 4155.1 REV-5, Paragraph 2-13. United Mortgage did not show that the borrower demonstrated an ability to accumulate savings. In regards to good earnings potential, United Mortgage did not provide evidence that there was a potential for increased earnings as indicated by job training or education in the borrower's profession. This is also required by HUD Handbook 4155.1 REV-5, Paragraph 2-12.

Case Number: 371-3356599
Loan Amount: \$85,950
Settlement Date: March 19, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment to effective income ratio was 48.62 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that this ratio cannot exceed 41 percent without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet. United Mortgage explained that the borrower had good cash reserves. The mortgage credit analysis worksheet indicated that the borrower had \$3,364 in assets available. However, the borrower brought \$1,878 to closing leaving only a balance of \$1,487. Thus, the assets that were adequately verified did not indicate that the borrower had good cash reserves as required by HUD Handbook 4155.1 REV-5, Paragraph 2-13.

United Mortgage's second compensating factor was good earnings potential. However, United Mortgage did not provide any documentation to show a potential for increased earnings as indicated by job training or education as required by HUD Handbook 4155.1 REV-5, Paragraph 2-13.

The third compensating factor was that the borrower earned bonus/overtime that was not used to qualify. However, there was no way to calculate the bonus/overtime accurately based on the verification of employment provided by United Mortgage.

Case Number: 374-4415719
Loan Amount: \$399,700
Settlement Date: August 26, 2004
Status: Default

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's mortgage payment expense to effective income ratio was 36.26 percent and the borrower's total fixed payment to effective income ratio was 49.08 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that these ratios cannot exceed 29 and 41 percent respectively without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet. Contractual pay increase was the first compensating factor. We took into account that the borrower was to receive a pay increase in 2004. However, the increase did not have a material affect on the ratios.

Conservative use of credit was listed as the next compensating factor. HUD Handbook 4155.1 REV-5, Paragraph 2-13 prescribes that the borrower must demonstrate an ability to accumulate savings and a conservative attitude toward the use of credit. United Mortgage did not provide evidence that the borrower had the ability to accumulate savings. Also, there were derogatory credit items on two of the three revolving accounts.

The third compensating factor was good earnings potential. United Mortgage did not provide any evidence that the borrower had a potential for increased earnings, as indicated by job training or education in the borrower's profession as required by HUD Handbook 4155.1 REV-5, Paragraph 2-13.

Case Number: 371-3401203
Loan Amount: \$82,650
Settlement Date: July 1, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment to effective income ratio was 49.53 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that this ratio cannot exceed 41 percent without listing significant compensating factors. There were three compensating factors listed on the mortgage credit analysis worksheet. Conservative use of credit and good savings ability were two of the compensating factors. HUD Handbook 4155.1 REV-5, Paragraph 2-13 prescribes that the borrower must demonstrate an ability to accumulate savings and a conservative attitude toward the use of credit. Six open lines of credit and sixteen other accounts that were either closed or had no current balance did not represent a conservative attitude toward the use of credit. In addition, the borrower's bank accounts demonstrated that the borrower did not have the ability to accumulate savings and that the borrower relied on four large deposits to meet his asset requirements.

The third compensating factor listed was contractual pay increases. United Mortgage explained that the borrower had been on the same job for five years. Also, the borrower received a raise in 2003. In addition, bonus and overtime income were likely to continue along with the probability of continued employment. Continued employment is a requirement for approving the loan. Also, bonus and overtime income were included in the borrower's effective income. Lastly, there wasn't any indication on the verification of employment of a proposed pay increase.

Case Number: 052-3495166
Loan Amount: \$157,500
Settlement Date: August 13, 2004
Status: Current

The Borrower's Debt-to-Income Ratios Exceeded the Acceptable Threshold Permitted by HUD

The borrower's total fixed payment to effective income ratio was 49.19 percent. HUD Handbook 4155.1 REV-5, Paragraph 2-12 states that this ratio cannot exceed 41 percent without listing significant compensating factors. There were two compensating factors listed on the mortgage credit analysis worksheet. Good earnings potential and contractual pay increases were not supported in the file. Additionally, United Mortgage did not provide any evidence that the borrower had a potential for increased earnings, as indicated by job training or education in the borrower's profession as required by HUD Handbook 4155.1 REV-5, Paragraph 2-13. United Mortgage explained that the borrower was to receive pay increases. In addition, they explained that the continuance of bonus income and overtime earnings were likely to continue and were not used in qualifying the borrower for the loan. The amounts of future pay increases were either not identified on the verification of employment or would have had a minimal effect on the ratios. Moreover, the bonus income was utilized as income to qualify the borrower, and the overtime income was minimal. The additional income did not have a significant impact on the ratios.